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THE ONTARIO COMMITTEE ON TAXATION

VOLUME III

THE PROVINCIAL REVENUE SYSTEM

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Introduction to Volume III

THE ORGANIZATION OF VOLUME III

1. This volume is devoted to the divers ways in which Canada's most populous province finances its programs. The magnitude of its fiscal operations is outlined in Chapter 4, but a few figures here will serve to re-establish in the reader's mind the importance to our economy of the provincial government's role. In the 1967 Budget Statement of the Provincial Treasurer, the net ordinary revenue for the year ending March 31, 1968, was forecast at $2,029 million. This amount is equal to 8.3 per cent of the forecast gross provincial product for 1967 and represents nearly $300 for every person living in Ontario. Even this understates the full magnitude of the funds at the disposal of the provincial treasury inasmuch as there are also large payments from the federal government toward provincial programs and substantial borrowings from the capital markets. In dealing with amounts of this magnitude, much of our attention was focused on those few sources that produce the great bulk of the revenue. However, we could not ignore the less important contributions to the treasury made by taxes that, although relatively small in significance, still yield many millions annually.

2. We first deal with a number of administrative matters generally applicable to provincial tax gathering, and examine the provisions and practices relating to the rights of taxpayers to appeal levies against them. Following this we discuss the major revenues available to the Province. A chapter is devoted to one tax except where repetition could be avoided by discussing in the one chapter several taxes of a like nature or where it was desirable to discuss comprehensively several taxes of special application to a particular industry or activity. Accordingly, the various levies arising from the ownership and operation of motor vehicles are treated in one chapter, as are the taxes and charges paid by the forestry industry. There are a number of taxes that Ontario does not levy, although it has the constitutional authority to do so. We have considered the most important of these alternative revenue sources, usually in conjunction with the related existing taxes. Two possible new sources are discussed in a separate chapter. The volume concludes with a discussion of debt, and the role that borrowing should play in the financing of provincial expenditures.

3. Although we have been forced, because of their number and variety, to treat the provincial revenues separately or in small related groups, we have tried, in our studies and in this Report, to consider each levy in the perspective of the entire revenue system. Thus the reader will find that we examine with some care the important economic implications of each major revenue source: discovering the magnitude of its burden and who actually bears it, what effects the levy can be expected to have on the working of the economy, and so on. In our assessment of the various levies we use the criteria described in the first volume of this Report. Our object has been to evaluate the major revenue sources by common standards, and to recommend changes that would contribute to a more equitable and efficient revenue system.

4. We recommend the abolition of some taxes, the introduction of new ones, and the modification of many. Although we have concentrated on the general principles that should be followed in redesigning the tax structure, we have found it necessary in some instances to make quite detailed recommendations showing how these principles ought to be applied. Nowhere, however, has it been our objective to develop our proposals in the detail or the form of draft legislation, as this is a task that must remain with qualified legislative draftsmen.

REPORTING PROVINCIAL REVENUE

5. Before examining the various revenues, we would like to mention the manner in which the Province accounts for the various moneys it receives. The Public Accounts, the Budget Statement and the abridged Financial Report are the three main annual publications containing information about revenues. The Budget Statement gives figures in regard to previous years and the current year (based on eight months' experience) as well as a forecast of the yield of the major sources for the forthcoming fiscal year. It is usually presented to the House in February. In November or December, the Treasurer publishes the abridged Financial Report, which contains a summary of the financial results of the fiscal year that ended on the preceding March 31. This is the first public statement of the results of a

fiscal year. Almost as soon as the Legislature sits in the winter, usually in January, the Public Accounts prepared by the Provincial Auditor are tabled, giving in detail the general information outlined in the Financial Report.

6. The three annual publications give appropriate reporting of the Province's financial operations. Of the three, the Public Accounts is the most complete, and it is this report that we discuss briefly here.

THE PUBLIC ACCOUNTS

7. In the course of our work we have had to make extensive use of the primary financial record of the government's activities—the Public Accounts. While this publication undoubtedly contains a wealth of information, much of it in clear and useful form, it is nevertheless singularly difficult to understand fully. Although we did not consider the efficacy of the Public Accounts to be sufficiently within our terms of reference to warrant detailed studies of the Accounts, we have nevertheless, through use, become acutely aware of some of the problems. Mentioning them should add impetus to whatever action may be under way to revise the form in which the Public Accounts are presented.

8. From the very outset of our work we were somewhat hindered because the Public Accounts are not designed to give a complete and comprehensive report of the operations of all the Province's departments and agencies. Essentially concerned with the Consolidated Revenue Fund, the Accounts give no details whatsoever of the operations of many important boards and commissions. The Ontario Hospital Services Commission, for example, is mentioned only in connection with the grants given to it by the provincial government. Nowhere is the income from hospital insurance premiums reported, nor are federal hospitalization grants mentioned. The operations of other important agencies such as the Workmen's Compensation Board and the Liquor Control Board are also missing. While reports of these varyingly independent bodies are available, their omission is a serious limitation to the usefulness of the Public Accounts as comprehensive financial statements. People inexpert in government accounts are almost certain to be misled, while the knowledgeable are inconvenienced.

9. Another way in which the Public Accounts hinder a full understanding of government finance is through the distinction drawn between "ordinary" and "capital" items of income and expenditure. This distinction is primarily one between day-to-day operating expenses and the cost of providing facilities that have lasting value, such as roads, buildings and other public works. It is a part of the role of government to build such facilities, just as much as it is to patrol highways, staff buildings with teachers, doctors and inspectors, and maintain and operate parks. There is no expectation that the government's expenditures on fixed assets will produce income in the same way that is expected of the capital expenditures of business. Nor can it be said that expenditures on a new road, for example, will benefit future taxpayers in a significantly different way from those on education or for the prevention of forest fires. Again, the capital requirements of a large provincial government typically do not fluctuate widely from one year to another; capital

outlays constitute a fully appropriate element in the Province's yearly budget. Indeed, the effect of showing separate ordinary and capital accounts is to obscure the full impact and magnitude of the government's fiscal operations, and to create a false impression of the budgetary surplus or deficit incurred. In this connection, we observe that certain investments and loans by government that are now shown in capital account are non-budgetary items that ordinarily should continue to be disregarded in the computation of the surplus or deficit of the year.

10. Many other examples could be found of practices used that hinder a clear understanding of the Province's financial position. An outstanding one is the method of accounting for the moneys supplied to universities for capital construction and equipment. Through the Ontario Universities Capital Aid Corporation, the government buys debentures issued by Ontario universities with the understanding that it will grant the funds needed to pay the annual debt charges including provision for debt retirement. Thus the money supplied for university expansion shows up as an expenditure not in the year it is advanced to the institutions but over subsequent years as the debentures are retired. Although the Public Accounts show the amounts advanced to and repaid by O.U.C.A.C. each year and the amount outstanding at the year end, there is no clear indication of the commitment for grants in future years. Regardless of the reasons for this presentation, in our opinion it disguises the true state of the government's financial position.

11. Another deficiency in the Public Accounts is the lack of consistency in the manner in which revenues are reported. One major source of income to the Province is the payments received from the federal government in connection with shared-cost programs. These payments may be treated in any of several different ways. If the related expenditure appropriation has been voted "gross"—the combined provincial and federal expenditure—the federal contribution is shown as a "Reimbursement of Expenditure". Where the expenditure is voted "net"—the Province's portion of the combined expenditure—the federal portion is called a "Government of Canada Repayment". If the federal contribution is received after the books are closed for the fiscal year in which the expenditure was made, it is shown as a simple revenue item classified under the Treasury Department and not related to the expenditure. If the federal payment is on behalf of a program operated outside the Consolidated Revenue Fund, as is the hospitalization scheme, the amount is not shown in the Public Accounts at all. Until the 1967-68 fiscal year, federal grants for certain welfare programs were received into and disbursed from the capital fund—yet another way in which federal moneys have been dealt with. Thus it is impossible to determine from the Accounts the total amount of money received from the federal government, and the amounts that are reported must be searched out from various hiding places in a book of over five hundred pages. We find this a particularly unfortunate practice, considering the importance of federal payments to the revenue.

12. It is the practice of the Province to report the yield from taxes on a net basis, showing only the amounts retained after paying out refunds and, for some taxes, the remuneration to vendors who act as agents in the collection of the tax.

In our view it is quite appropriate that taxes be reported net of refunds to persons who overpay their taxes or who claim rebates because of exemptions from such taxes as sales or gasoline taxes. Sufficient details of refunds are given in the Public Accounts to satisfy all but the most assiduous searchers after facts. On the other hand, we think it is important to show the amount of taxes before remuneration to vendors is deducted. The use of agents to collect taxes, as with the gasoline tax, the retail sales tax and the security transfer tax, is a convenient administrative device. There is no important distinction between payments made for these services and those made to Treasury Department staff involved in the administration of taxes. Furthermore, the Public Accounts should show the amount of tax actually and properly paid by the public, a figure that the present method of accounting does not provide.

13. For all these reasons, *we recommend that*:

After due study, the form of the Public Accounts be revised so as to provide a comprehensive and more meaningful presentation of the revenues, expenditures and financial position of the provincial government and all its agencies. 24:1

14. In Chapter 3, we point out the need for a secondary presentation of government fiscal operations on a national-accounts basis to permit the economic analyses necessary for effective development of fiscal policy. *We therefore recommend that*:

In addition to the financial statements prepared by the Provincial Auditor, government revenues and expenditures be classified and presented on a national-accounts basis. 24:2

15. We now turn to examine the taxation and revenue system of the Province of Ontario.

Chapter 25

Provincial Revenue Legislation: Administration and Appeals

INTRODUCTION

1. Tax gathering in modern times is becoming a sophisticated operation that attempts to inflict the least pain on the greatest number of citizens. In earlier days, the monarch, over the protests of a weak Parliament, exacted taxes for expenditure purposes that were of his own devising and frequently of little use to his subjects. Today, in the age of constitutional democracy, government makes every effort to convince its citizens that the purposes for which revenue is raised are in the interest of all. But while the citizen now has ample opportunity to register his views on tax levels and expenditure programs, it remains true that the collection of taxes, once these have been duly legislated, rests not on individual consent, but on force and authority. Consequently, vestiges of the arbitrary techniques and attitudes of the monarchs of old have remained the rule in the administration and collection of our revenues.

2. The revenue-raising statutes of Ontario strike a very uneven balance between the rights of government and the rights of the taxpayer. It is fair to say that in all these statutes the Crown is well protected, and so the problem we face is how to safeguard the rights of the citizen in a manner consistent with those of the Crown.

This chapter is accordingly concerned not with tax structure or policy, but rather with the application of the principles of simplicity, certainty and the equal treatment of equals to provincial tax collection and administration. Parallel problems that arise in the municipal sphere are treated elsewhere in this Report.

ADMINISTRATIVE RESPONSIBILITY FOR REVENUE STATUTES

3. The Treasury Department of Ontario administers most provincial revenue statutes through the several branches of its Revenue Division. Certain other statutes are administered by such Departments as Mines, and Lands and Forests. Table 25:1 outlines fifteen of the major revenue statutes of the province, together with the revenue derived therefrom in 1965-66 and the name of the government body charged with administrative responsibility. Total revenue derived in 1965-66 from the statutes shown in Table 25:1 was somewhat in excess of $834 million, and its collection involved the employment of slightly over 1,100 public servants.

TABLE 25:1

FIFTEEN ONTARIO REVENUE STATUTES, 1965-66:
REVENUE AND ADMINISTRATIVE BODY

Statute	*Revenue 1965-66*	*Treasury Department Branch or Government Department*
The Corporations Tax Act	$252,376,000	Corporations Tax Branch
The Fire Marshals Act	715,000	
The Logging Tax Act	2,257,000	
The Gasoline Tax Act	236,829,000	Gasoline Tax Branch
The Motor Vehicle Fuel Tax Act	14,678,000	
The Tobacco Tax Act (3 months)	2,002,000	
The Hospitals Tax Act	6,791,000	Hospitals Tax Branch
The Land Transfer Tax Act	6,706,000	Security Transfer Tax Branch
The Race Tracks Tax Act	12,162,000	
The Securities Transfer Tax Act	4,200,000	
The Retail Sales Tax Act	220,998,000	Retail Sales Tax Branch
The Succession Duty Act	56,968,000	Succession Duty Branch
Total, Treasury Department	$816,682,000	
The Provincial Land Tax Act	1,529,000	Department of Lands and Forests
The Mining Act	1,394,000	Department of Mines
The Mining Tax Act	14,954,000	
Total	$834,559,000	

4. The fifteen statutes cited in the Table by no means encompass all provincial revenues. The Income Tax Act (Ontario), which covers the taxation of personal income, is excluded because it is administered under a collection agreement by the federal Department of National Revenue. Other significant revenue sources, notably

those administered by the Ontario Hospital Services Commission, the Liquor Control Board and the Liquor Licence Board, are excluded because the responsible agencies stand apart from the regular departmental structure. Likewise, numerous licences and other fees, rentals and miscellaneous revenues administered by various government departments and separate boards and commissions have been omitted for the sake of simplicity. While this chapter will be based specifically on a review of the fifteen important statutes administered directly by the government departments and Treasury branches outlined in the Table, we consider the principles developed herein to be generally applicable. Accordingly, our recommendations apply, where appropriate, to all revenue statutes whether specifically cited or not.

5. There are four essential elements in the administration of any particular revenue system. These are:

(1) an assessment or billing procedure;

(2) collection of the tax and refund of overpayments;

(3) enforcement and imposition of penalties, including liens; and

(4) procedures for reviewing complaints and processing appeals.

We shall proceed to make these four elements the principal headings of the discussion that follows. Our philosophical starting point is simply that while the details may vary with the nature of the tax, the rights of the citizen and of the Crown in tax administration ought to be uniform. This is not true of the present revenue statutes of Ontario. Moreover, as we shall have occasion to document, there exists in this province a conspicuous lack of any consistent policy with respect to assessment, collection and review procedures.

6. This leads us to comment at the outset of our discussion on general administrative responsibility for the raising of revenue. It is well known that the greatly increased level of government revenue made necessary in recent decades by the expansion of the public sector has had far-reaching economic consequences. Less known, but equally inescapable, is the fact that the growth and multiplication of government revenue sources pose new and difficult problems in public administration and in the field of civil rights. It is highly important that government be in a position to develop and apply improved administrative techniques in revenue raising that will result in the greatest possible efficiency. Simultaneously, if it is to be faithful to the dictates of constitutional democracy, government must bend every effort to protect and enhance the rights of the individuals against whose income and property it lays revenue claims.

7. The attainment of these challenging objectives requires two things. First, there must be an on-going effort at the highest levels of government to develop broad, consistent and rational public policies in the revenue-raising field. Second, responsibility for the day-to-day administration of revenue statutes and for a detailed review of procedures under these Acts should be pinpointed as closely as possible. The ability of government to meet these twin requirements hinges to no small extent on its organizational structure. Among the possible structural alternatives, it is our considered opinion that a separate department in which the main

revenue responsibilities are brought together offers the greatest advantages. Such a department would facilitate the consolidation of assessment, collection and appeal procedures for all major revenue statutes. While consolidation might admittedly be possible within the structure of an existing department, a revenue department would emphasize, by the very fact of its distinct departmental status, responsibility for the efficient and equitable administration of tax statutes. In addition, separating tax policy formulation from tax administration would enhance in the public eye the importance that government attaches to revenue-raising policy and would enable Treasury Department to concentrate its attention on broad questions of fiscal and economic policy. We note that, to all appearances, experience with both the federal Department of National Revenue and the Department of Revenue of the Province of Quebec has been highly favourable. In dealing first with the revenue statutes now under the Comptroller of Revenue, *we recommend that:*

> ***The Government of Ontario establish a Department of Provincial Revenue responsible for the administration of all revenue statutes now administered by the Treasury Department under the Comptroller of Revenue.*** **25:1**

8. There exist also, as we have noted, a number of revenue statutes which are, at present, assigned to boards and commissions or to a department other than Treasury. Two particularly good examples are The Liquor Control Act, assigned to the Liquor Control Board of Ontario, and The Mining Tax Act, administered by the Department of Mines. We realize fully that there may at times be excellent reasons for assigning revenue statutes to particular boards, commissions, or operating departments. These reasons will be especially strong when the statute in question is one in which the raising of revenue takes second place to another function—the regulation of motor vehicles, for example. On the other hand, where the purpose of the statute is primarily that of revenue collection, considerations of efficiency indicate that the Minister of Provincial Revenue should be made responsible, either by transferring the administration of the statute to his department or by designating him the minister answerable for the revenue-raising board or commission. Accordingly, *we recommend that:*

> ***A review be made of all revenues not at present collected by the Treasury Department with a view to consolidating revenue administration in the proposed Department of Provincial Revenue.*** **25:2**

ASSESSMENT

9. The revenue statutes of Ontario are of two types—one requiring that the tax be paid *directly* to the government by the taxpayer, the other prescribing that the tax be paid to an *agent* of the government. The first type comprises the normal method whereby government imposes and collects its taxes; the second method has been devised because Section 92(2) of the British North America Act requires the provinces to raise revenue by "direct" taxation. Judicial decisions have defined a direct tax as one which is demanded of the very person who it is intended should

pay it and which may not be passed on in the ordinary course to others. The provincial governments have complied with this limitation by imposing the tax on the very person who is to pay it and by appointing the individual who deals directly with the person being taxed as the agent of the government in collecting the tax.

AGENCY-COLLECTED TAXES

10. Seven Ontario statutes prescribe the agency method of collection. They are:

The Retail Sales Tax Act,
The Gasoline Tax Act,
The Motor Vehicle Fuel Tax Act,
The Hospitals Tax Act,
The Race Tracks Tax Act,
The Security Transfer Tax Act,
The Tobacco Tax Act.

These statutes do not require an assessment procedure as such because the tax is collected from the taxpayer either on an *ad valorem* or on a *specific* basis. An *ad valorem* tax, of which the retail sales tax is an example, involves a fixed percentage of the purchase or sale price of the article or service. A *specific* tax, on the other hand, involves a fixed amount of tax per unit purchased, as, for example, sixteen cents per gallon under The Gasoline Tax Act.

11. Whether the tax is *ad valorem* or *specific*, the agent who has collected it is required to remit his receipts to the Treasurer of Ontario, and Treasury auditors periodically check the agent's records in order to determine whether the proper amount of tax has in fact been remitted. If the auditor finds a shortage, he then "assesses" the agent for the amount of tax that has not been duly remitted. While we recognize that the administrative difficulties relating to each statute vary, we consider it most necessary that agents be audited at frequent intervals, say at least every two years, so that they will have a reasonable opportunity to correct any errors they may be making in the collection of the tax. We note that any amount of tax which the agent ought to have collected, but has not, must be paid by him personally. Therefore, long periods between audits can have significant financial consequences for the agent, consequences which we believe should not attach to an equitable revenue system. Accordingly, *we recommend that:*

Statutory provision be made for the regular audit of agents who collect taxes, and that, except in cases of misrepresentation, fraud, or failure to remit tax collected, assessments for unpaid tax, together with interest, be limited to the two-year period before the audit, but that interest continue to run thereafter until the taxes assessed are paid. **25:3**

DIRECTLY COLLECTED TAXES

12. The remaining tax statutes under consideration provide for collection not through an agent but directly by government. These statutes either require that specified information be filed by the taxpayer, or provide that the authorities calculate the tax on the basis of material forwarded by the taxpayer and information in

the departmental files. The latter or "billing" method is used for taxes imposed under The Mining Act and The Provincial Land Tax Act. Under the former or "self-assessing" method, the act of assessment by the authorities confirms or varies the taxpayer's estimate or notion of the amount of tax payable by him. If the billing method is followed, penalty for non-payment runs only from a specified date after the bill or account has been rendered. But under the "self-assessing" method, the interest penalty for non-payment runs from the date when the tax payment should have been made without reference to the date of assessment. It is thus possible under this method for a taxpayer to receive, some years after he has duly paid tax in an amount believed by him to be correct, an upward revision of his original assessment on which the interest penalty will have run throughout the period without his knowledge. While this system doubtless encourages accurate calculation of tax by the taxpayer, it can impose an unduly harsh interest penalty on the conscientious person who has made an honest mistake. Hence it is important, particularly in "self-assessing" statutes, that the provincial act of assessment or reassessment be accomplished within reasonable time. Accordingly, *we recommend that:*

> ***All revenue statutes that provide for collection through a "billing" or "self-assessing" method include the requirement that any assessment by the Province be made "with all due dispatch" and that, in the absence of misrepresentation or fraud, interest imposed for the period prior to assessment or reassessment for any deficiency in tax be limited so that it does not extend beyond two years from the date that the return was filed, or required to be filed, whichever is later.*** **25:4**

GENERAL ASSESSMENT PROCEDURES

13. It is our firm opinion that no person should be in jeopardy of paying tax for an indefinite time. In our laws, we have a Statute of Limitations which clearly sets out how long a person may delay the commencement of an action to assert his claim. Similarly, there should be a degree of limitation on the right of the government to assess and reassess. *We therefore recommend that:*

> ***All revenue statutes prohibit, except for fraud or misrepresentation, any reassessment of a taxpayer after the expiry of six years from the date of the first or original assessment or after any shorter period of time specified in an applicable intergovernmental tax collection agreement.*** **25:5**

14. In all government assessments, billings, or statements of tax payable, fairness to the citizen demands that the authority or basis and, where applicable, the reason for tax demands be clearly stated. The doing or refusing of administrative acts authorized in revenue statutes also requires that clear and written reasons always be given to the person affected, and often to the public at large. The general publication of reasons where individual privacy is not paramount can have a desirably upgrading effect on the adequacy of the reasons that an official or board may have for its decisions. The Liquor Licence Board, for example, has been

required since 1951 to make public its reasons for cancelling a licence. If civil rights are to have their full and proper due, the citizen should know specifically the basis and reason of any assessment or administrative act which affects him. This is essential, among other things, for the effective exercise of his right to appeal, with which we deal later in this chapter. Accordingly, *we recommend that:*

> ***Each revenue statute require that administrative officials, boards or commissions state fully and clearly in writing to the person involved the authority or basis of their actions, together with the reasons by which they justify their actions, and that, where the privacy of the person is not affected, these reasons be published whenever this is deemed to be in the public interest.*** 25:6

15. In addition, we note that assessment decisions frequently hinge upon prior interpretations of revenue statutes made within the responsible department, board or commission. Because such interpretations can be of vital interest to the taxpayer and can greatly affect his position, *we further recommend that:*

> ***The Government of Ontario publish from time to time Information Memoranda setting out administrative interpretation and procedures of its revenue statutes.*** 25:7

TAX COLLECTION AND REFUNDS

AGENCY-COLLECTED TAXES

16. Where the province collects its tax through an agent, a common practice is to require that the agent be licensed. Generally, no person selling a taxable article or service may do business unless he has a licence. Under certain statutes, a fee is charged upon the issuance of a licence. By the terms of The Gasoline Tax Act, no licence is required but every agent must furnish a surety bond. Broad administrative discretion in matters pertaining to collectors' licences and fees is the general rule.

17. The dictates of administrative necessity must be accorded their due. But inasmuch as the Crown requires some of its citizens to perform a service for it, neither the charging of fees nor discretion in the issuance or reissuance of licences seems to us appropriate. Agents' licences exist to make feasible the administration of tax collection. Their objective is not to control who may or may not carry on business. A public official under the guise of tax administrator must not be permitted arbitrarily to determine what persons may engage in business. Revenue statutes provide penalties for non-payment of tax and for other infractions that should be applied in all proper cases. But refusal to grant a licence is not a proper course of administrative action. Where collection experience has been bad, the proper remedy, other than the imposition of penalties, is to require an adequate bond. Accordingly, *we recommend that:*

Fees for the issuance of collectors' and agents' licences be abolished and that no collector's or agent's licence be refused issuance or reissuance except upon failure to obtain a surety bond when required. **25:8**

REFUNDS

18. At common law, the taxpayer can recover an overpayment of tax from the Crown only if the overpayment arises out of a mistake of fact and not of law. While exact demarcation between fact and law can be very difficult, it is clear that the existence or construction of a statute is a matter of law. Therefore, unless there exists specific statutory authority to make a refund, overpayments will be considered as arising from mistakes of law and will not be subject to refund. As presently constituted, three provincial revenue statutes, The Fire Marshals Act, The Insurance Act and The Race Tracks Tax Act, do not provide for refunds, while thirteen others do.

19. Among the statutes that provide for refunds, five—The Corporations Tax Act, The Income Tax Act (Ontario), The Logging Tax Act, The Mining Tax Act and The Retail Sales Tax Act—lay down conditions under which a refund is payable, and apply various interest rates for differing periods during which the overpayment has been held by the Treasurer. As to the remaining statutes, the granting of a refund, while authorized, is left wholly to the discretion of the Treasurer.

20. While government revenue must be protected and the stupidity or carelessness of the taxpayer not overly indulged, we are of the firm opinion that all statutes should provide for refunds and stipulate clear criteria under which these can be paid. The act of granting or withholding should not be discretionary. Refunds should be automatic following the discovery and determination of overpayment, whether upon assessment or reassessment, upon audit of an agent or collector, upon appeal, or upon application by the taxpayer within a reasonable period determined by the nature of the tax. *We therefore recommend that:*

Provision be made in all revenue statutes for a right of refund where overpayment has been made, whether under mistake of fact or of law. **25:9**

21. Where the taxpayer has overpaid, equity demands that he receive interest on the amount refunded. If the amount has been mutually agreed upon by the taxpayer and the government, the rate of interest should be somewhat below current borrowing rates. This is to avoid a situation where taxpayers might consider themselves invited to use the government as a savings deposit institution by making deliberate overpayments. On the other hand, where overpayment is not determined until after a dispute between the government and the taxpayer, it is only fair that the taxpayer receive interest on overpayment and penalties, if any, at a rate comparable to going market rates. Each revenue statute should provide the right to interest on overpayments on a uniform basis, and the rates should be fixed from time to time by the Lieutenant Governor in Council. We suggest that the rates for overpayments determined upon an objection to a Board of Review or an appeal to

a Court should not exceed the prime lending rates of chartered banks, and the rates for other overpayments should not exceed 3 per cent per annum. Accordingly, *we recommend that:*

Appropriate statutory provision be made for interest to be paid in respect of all overpayments. **25:10**

PENALTIES AND LIENS

PENALTIES

22. Where tax payments are delayed past the statutory deadlines, or where there is a shortage in the amount of tax paid, the practice of charging an interest penalty is applied by all Ontario revenue statutes except The Fire Marshals Act, The Gasoline Tax Act, The Insurance Act, The Land Transfer Tax Act and The Race Tracks Tax Act. The amount of interest levied is 6 per cent—the former maximum charged by banks—save in The Hospitals Tax Act and The Motor Vehicle Fuel Tax Act, where it is 7 per cent, and The Corporations Tax Act, where it is 9 per cent.

23. We can find no valid reason for the present variation in the level of interest penalties imposed by different revenue statutes. Nor does the practice of charging an interest penalty that is no higher than the maximum rate charged by banks commend itself to us. Such a practice makes it possible for taxpayers to "borrow" from the very government to which they owe money at a cost no greater and under circumstances more favourable than prevail in the banking system. The "loan" is obtained on an easy, "no questions asked" basis, and can enable the taxpayer to finance other expenditure while delaying the fulfilment of his tax obligation. Meanwhile, the government must bear the administrative cost of delayed or delinquent tax payments. For these reasons, *we recommend that:*

The penalty provisions in all revenue statutes provide that interest is to be payable in respect of overdue amounts at a uniform rate, in excess of the maximum rates ordinarily charged by banks, to be set periodically by the Lieutenant Governor in Council. **25:11**

24. In order to ensure general compliance with the law, there are severe penalties throughout the revenue statutes for failure to file tax and various information returns. Some penalties are so severe in relation to the nature of the returns required that the government fails to apply them. Extensions of time granted by administrative discretion can, no doubt, moderate the severity of the law without precluding proper enforcement. Yet there is no provision for a discretionary extension of time in many of the revenue statutes, including The Gasoline Tax Act, The Mining Act, The Mining Tax Act, The Provincial Land Tax Act, and The Succession Duty Act. *We therefore recommend that:*

All revenue statutes provide a reasonable but effective penalty for delinquent and late filing of returns, and grant to the minister responsible discretionary power to allow, where appropriate, extensions of time for the filing of tax, information and other returns. **25:12**

LIENS

25. Eight revenue statutes provide for a first lien or charge on the property of a taxpayer who has failed to pay the tax, interest, penalties and costs imposed by law. Because a lien or charge is an encumbrance on the taxpayer's property title, any sale or security transaction respecting the property remains subject to the lien, to the detriment, in many cases, of innocent third parties such as purchasers or their security holders. As a matter of administrative practice in corporation tax collection, for example, the Comptroller of Revenue may issue, upon request of the purchaser of property from a company, a letter stating that the Province claims no lien for corporation taxes with respect to the property in question. The letter will be given if the company has paid all prior years' taxes and is up-to-date in the payment of instalments on current year's taxes. But such a letter notwithstanding, a lien will become effective the instant the government discovers any unpaid tax, interest, penalties or costs that were due at or before the time of sale.

26. It has been suggested that a Crown lien should be effective only if the Crown has given notice of its claim by registering it in an appropriate registry or court office. This is not a practical proposal because the Crown cannot acquire on short notice the information necessary to determine whether taxes are in arrears, or to register notice of the lien. The ensuing administrative burdens would be at once unacceptable and unjustifiable. Nevertheless, it is our considered view that purchasers of property should not be made to suffer because of administrative difficulties. Accordingly, we believe that they should be protected from liens in any case where they purchase property for value and have obtained a certificate from the minister responsible showing no claim for taxes. *We therefore recommend that:*

> ***All revenue statutes that provide for liens against the property of delinquent taxpayers give authority to the minister responsible to issue certificates of no claim for lien, which shall be binding on the Crown in respect of a transaction in which the applicant is involved that is completed within a stated period.*** **25:13**

APPEAL PROCEDURE

27. A basic point that should be emphasized in any consideration of the law regarding rights of appeal is that there is no right of appeal, whether from the imposition of a tax or from the decision of an administrative board, unless this right is specifically provided for by statutes. As presently constituted, seven Ontario revenue statutes make no provisions regarding appeals. These are The Fire Marshals Act, The Gasoline Tax Act, The Hospitals Tax Act, The Insurance Act, The Motor Vehicle Fuel Tax Act, The Race Tracks Tax Act, and The Security Transfer Tax Act. While all other major revenue statutes contain appeal provisions, these vary widely in scope and effectiveness. The Corporations Tax Act lays down an appeal procedure that parallels that provided by the federal Income Tax Act. This procedure commences with a Notice of Objection to an assessment, followed by a notification from the Treasurer of his reply which, if unfavourable, permits a

notice of appeal to be given. A judicial hearing will then proceed before the High Court of Justice for Ontario, and thence upon further appeal to the higher courts in accordance with their rules. For its part, The Land Transfer Tax Act provides for a review by the Treasurer or his nominee if, and only if, the taxpayer has paid his tax under protest. Then The Provincial Land Tax Act permits an appeal to a county or district judge, whose decision is final and binding without further appeal. Again, while The Succession Duty Act seems to provide a full appeal, no proceeding may commence until the Treasurer has issued the statement of duty, an action which he is under no obligation to take expeditiously. Then there exist numerous boards, commissions and officials whose decisions are based on unknown rules and criteria and are not subject to the review of the courts. In short, the revenue statutes of Ontario provide anything but a reasonable and uniform appeal procedure.

28. In our opinion, a proper appeal procedure must be based on an administrative system that provides to the citizen full information as to the authority and reason for its actions. We have already laid the groundwork for such a system through a recommendation made earlier in this chapter under the heading of assessment procedures. Beyond the disclosure of the information on which a citizen can judge the fairness of government action, we believe that a proper appeal procedure requires twin processes, one administrative, the other judicial.

THE ADMINISTRATIVE PROCESS

29. To be adequate, the administrative process involves two steps. The first is an administrative review by the responsible department of the assessment, billing or other government decision, together with the data supporting the decision and the data supporting the objection. The second step, which becomes operational if the taxpayer wishes to challenge the findings of the administrative review, is a hearing before a formal board. The existence of these two steps provides ample opportunity for correcting any decision based on inadequate or misconstrued facts without reference to the courts.

30. The implementation of a full administrative process for the handling of appeals in Ontario requires the creation of a Board of Review. We have given close consideration to the question of what department of government might appropriately be responsible for such a board. We note that while the bulk of appeals would undoubtedly be from administrative reviews carried out in our projected Department of Provincial Revenue, there would surely be some from the actions of other departments and of such revenue-raising agencies as the Ontario Hospital Services Commission. To ensure that the Board of Review operates within a reasonably independent environment, it appears to us that it might appropriately be placed in the Treasury Department which, under our proposals, would no longer be involved directly in the administration of revenue statutes. Accordingly, *we recommend that:*

A statutory Board of Review be constituted within the Treasury Department to hear objections to the assessment of taxes, the levying of other charges, and any other administrative acts performed under authority of the revenue statutes. 25:14

31. Upon the creation of a Board of Review, it is our view that the administrative process should function along the following lines:

(1) The Board of Review should be composed of three members—a chairman and two others appointed by the Lieutenant Governor in Council. If experience indicates that the Board is overworked, provision should be made for additional members and for concurrent sessions.

(2) Each revenue statute should give a taxpayer the right to file with the minister responsible a written Notice of Objection respecting any revenue matter to which he has taken objection. Filing should take place within a fixed time, say ninety days, from the day of the assessment or billing of the tax or other charge, or from the date of the administrative act to which objection is taken. One copy of the Notice should be sent to the Treasurer.

(3) The minister responsible should be required, again within a fixed time such as ninety days, to notify the taxpayer and the Treasurer of his decision. If the minister has not fully accepted the objection, the Treasurer should be required to fix forthwith a time and place for a hearing before the Board of Review and give notice thereof to the taxpayer and to the minister.

(4) The taxpayer should be permitted to support his objection before the Board with further evidence and submissions made in writing, in person or through an agent.

(5) Decision of the Board of Review should be binding on all parties but may be appealed through the judicial process.

32. With respect to the decisions of the Board of Review, it will be readily evident as a matter of common sense that the publication of the Board's decisions, where these are of general interest, will prove no less desirable than the publication of administrative interpretations pertaining to revenue statutes. Accordingly, *we recommend that:*

> ***On the recommendation of the Chairman of the Board of Review, the government publish from time to time those decisions of the Board that are matters of general public interest.*** **25:15**

THE JUDICIAL PROCESS

33. Under a proper appeals procedure, the judicial process should not only supplement but parallel the administrative process. It is, of course, necessary for the taxpayer to have the right to appeal from the outcome of the administrative process to a court of law. But there will be instances where the matter at dispute is sufficiently grave, or the stakes to the taxpayer sufficiently high, that a direct appeal to the courts from an administrative decision or review is warranted. We are accordingly of the opinion that the taxpayer should be able to bring the dispute to a full court hearing with the leave of the court before or while having recourse to the administrative process and as a matter of right upon the conclusion of the administrative process. We suggest that court proceedings be in the first instance

before the High Court of Justice for Ontario. In revenue matters this Court would assume the position of the first judicial body to consider the taxpayer's liability and have full powers to this end similar to those of the Exchequer Court in federal tax matters. All normal rights of subsequent appeal to the Court of Appeal for Ontario and the Supreme Court of Canada should apply after the High Court has rendered its decision. *We therefore recommend that:*

> ***Each revenue statute provide a right of appeal to the High Court of Justice for Ontario from any assessment, levy, administrative act or review upon obtaining leave of the Court, and from any decision of the Board of Review as a matter of right.*** 25:16

34. We suggest that the judicial process, broadly speaking, should operate as follows:

(1) An appeal to the High Court should be instituted by serving on the minister responsible a Notice of Appeal in a prescribed form in duplicate and by filing a copy thereof with the Registrar of the Supreme Court of Ontario.

(2) The appeal to the High Court should be permitted within a fixed time, say ninety days,

   (a) with leave of the Court, from the day of the assessment or billing of the tax or other charge, or from the day of the administrative act to which objection is taken; or

   (b) with leave of the Court, from the date on which the minister responsible has replied to a Notice of Objection; or

   (c) as a matter of right, from the date of the decision of the Board of Review; or

   (d) as a matter of right, any time after a lapse of six months from the date of the hearing before the Board of Review if the Board has not rendered a decision.

(3) The practice and procedure of the Supreme Court of Ontario, including the right of further appeal, and the practice and procedure relating to appeals should apply.

35. If is to be fully effective in determining tax appeals, the judicial process should not be considered exempt from what has become the hallmark of modern tax practice—specialization. We believe that tax appeals generally have suffered from the long-standing judicial theory that all judges are equally capable of determining any matter before them. Where revenue matters are involved, we accordingly think that it is most desirable that the trial judge have special experience. The effectiveness of the appeal procedure that has just been outlined could be greatly enhanced if the Chief Justice of the High Court were to designate one or more of the members of his court to be a judge in revenue appeals. For this reason, *we recommend that:*

> ***The Chief Justice of the High Court be requested to designate one or more of the members of his Court as a judge or judges in revenue appeals.*** 25:17

RELATED CONSIDERATIONS: COSTS AND TIME LIMITS

36. Traditionally, the cost of appealing through the administrative process has always been borne by the Crown. This is because an administrative process of appeal is considered to be intimately tied to the general procedure whereby the Crown raises revenue. Because our projected Board of Review is an integral part of the administrative process, *we recommend that:*

> ***No costs be charged on any hearing before the proposed Board of Review.*** **25:18**

37. As to the matter of costs as they pertain to appeal through the judicial process, considerable difficulty arises. We note that when costs are at present awarded to the appellant, they seldom cover his actual expenses. Hence in ascertaining his proper tax, the taxpayer has usually been the loser even when awarded costs. We take the view that the judicial process is an extension of the general collection procedure of the Crown. While this view indicates that costs generally should not be borne by the appellant taxpayer, we do recognize the force of this historical argument to the effect that the Court should not be plagued by proceedings that should never have come before it. Accordingly, *we recommend that:*

> ***Statutory direction be given to the Supreme Court of Ontario to award costs as between a solicitor and his client to the appellant and against the Crown unless the Court considers that the appeal is frivolous and vexatious or that the appellant had previously withheld pertinent evidence.*** **25:19**

38. To the extent that the above procedures leave open a limited possibility that costs will be adverse to the appellant, the question of security poses itself. At present, five of the revenue statutes that provide appeal procedures require the taxpayer to post security for costs ranging from $200 to $1,000. Normally, the amount of security is subject to variation at the Treasurer's discretion. By contrast, no security for costs is required in the majority of civil cases that come to the courts. We believe that if a taxpayer is to have a fully effective right of appeal, his access to the court should be as easy as if he were litigating a matter with a fellow citizen. Accordingly, *we recommend that:*

> ***All revenue statutes provide that security for costs, if any, be at the discretion of the Court.*** **25:20**

39. As a final consideration in the realm of appeal procedures, there is the matter of time limits. Because of the traditional view that appeal is a privilege granted by the Crown to its subject, the general practice has been to confine procedure within strict time limits. In that we are fully cognizant of the difficulties inherent in tax administration, we are generally sympathetic to the prescription of time limits. But there arise all too often cases of individual hardship for which the tax law makes no provision. For instance, where an appeal procedure requires the mailing of a notice by a particular time, the fact that there might be a postal strike is

at present irrelevant. Again, existing provisions do not cover a situation where the taxpayer, through no fault of his own, may have received from the government a demand for tax after the prescribed time period has elapsed. The foregoing are just two examples, but they could be multiplied many times over. We believe that a degree of flexibility in matters of time is highly desirable, and that it can be countenanced without sacrificing administrative efficiency. *We therefore recommend that:*

> ***Wherever a revenue statute imposes a time limit within which to take a step in the appeal procedure, such limit be extended on application to the Supreme Court of Ontario upon such terms as the Court thinks equitable under the circumstances.*** 25:21

CONCLUSION

40. The most striking fact that emerges from the foregoing review of Ontario revenue statutes is the absence of any consistent policy. Variations among statutes are, of course, to be expected in so far as different taxes may require different administrative procedures. But such necessary variations certainly do not preclude an over-all policy on administration, collection, penalties and appeals. While it was not possible for us to examine in detail each and every statutory provision of the revenue system that affects the respective rights of the Crown and its citizens, we have made recommendations which we believe will provide a blueprint for consistent policy in years to come.

41. Given the enormous complexity of the subject matter, we are of the opinion that there is a real need for a continuing review of revenue statutes if uniform civil rights are to be obtained and protected. We note that the Royal Commission presently inquiring into civil rights is reviewing all Ontario statutes, and are confident that its thorough examination of the revenue statutes will constitute a significant prime step toward our goal. We are acutely conscious, however, that revenue raising in particular is an activity where the price of liberty is constant vigilance. We thus consider it highly desirable to have a regular and on-going effort in this field. A select committee of the Legislature composed in part of members experienced in revenue matters could perform an invaluable task by subjecting the administrative provisions of revenue statutes to periodic review. Such a select committee, soliciting public submissions and reporting to the Legislature at regular intervals—say every five years—could be the rock on which a truly equitable revenue structure would be maintained. Accordingly, *we recommend that:*

> ***A Select Committee of the Legislature on Civil Rights in Revenue Legislation be appointed to make a periodic review of all revenue statutes of Ontario for the purpose of ascertaining whether or not a constant and uniform policy respecting the rights and duties of citizens is being maintained.*** 25:22

Chapter 26

The Personal Income Tax

INTRODUCTION

1. At the time of Confederation, direct taxation—to which the taxing powers of the provinces had been confined by the British North America Act—was virtually non-existent at the provincial level. Income taxes were levied, however, by several municipalities, either as a part of the tax on personal property (under statutes in which "personal property" was so defined as to include "income") or as an alternative to this tax.

2. As the costs of discharging their responsibilities grew far beyond what had been anticipated at the time of Confederation, the provinces found themselves confronted with rapidly rising debt charges. This circumstance, coupled with repeated failures to secure from the federal government sufficient increases in subsidies, the major source of provincial revenue, necessitated the entry of one province after another into the field of direct taxation. With respect to the personal income tax, British Columbia led the way in 1876, with a levy of 0.5 per cent on incomes in excess of $1,500. In 1897 the same province also pioneered the progressive rate structure which is such an important characteristic of the present

personal income tax, replacing the initial flat rate by rates ranging from 1.25 to 1.75 per cent.

3. By the outbreak of World War II, six other provinces had followed British Columbia into the field of direct taxation. Prince Edward Island adopted the personal income tax in 1894, Manitoba in 1923, Alberta and Saskatchewan in 1932, Ontario in 1936 and Quebec in 1940, but as yet no government relied on this tax as a major revenue source. For example, in 1913 it still accounted for only 0.3 per cent of total provincial government current revenue, and 1.28 per cent of total provincial taxes.[1] The rise of this tax to a position of pre-eminence among revenue sources had to await its vigorous use by the Dominion government in meeting the unprecedented financial requirements generated by World War II.

4. The adoption of direct taxation by the federal government had been delayed by a reluctance to encroach upon the general area of taxation to which the provinces (and so the municipalities, which derived their powers of taxation from the provinces) had been restricted by the British North America Act. It was not until 1917 that sharply rising debt charges, coupled with an aroused public sentiment that wealth was not incurring a sufficiently large sacrifice on behalf of a nation at war, forced the federal government to introduce personal and corporate income taxes. The Income War Tax Act of that year subjected individual incomes to a normal tax of 4 per cent, and to a graduated supertax, at rates ranging from 2 to 25 per cent, on personal income in excess of $6,000. It is of interest to note that in introducing this income tax, the Minister of Finance, Sir Thomas White, made it clear that he did not expect it to become a permanent national tax. Rather, he expressed the view that "a year or two after the war is over, the measure should be deliberately reviewed by the Minister of Finance and Government of the day with a view of judging whether it is suitable to the conditions which then prevail."[2]

5. Although introduced in 1917, the tax did not yield any revenue until the fiscal year ending in 1919, when it accounted for $7.9 million, or 3.4 per cent of the total tax revenue of the Dominion government. Thereafter, its yield rose steadily, until in 1922 it accounted for 12.4 per cent of the federal government's tax revenue. This order of importance as a revenue source was maintained throughout the twenties and thirties, giving way to a higher order only under the exigent circumstances of World War II, during which it produced as much as 28.7 per cent of federal tax revenue. Reliance upon the personal income tax base has since increased, until now, on the fiftieth anniversary of the Income War Tax Act of 1917, it accounts for approximately one-third of the tax revenue of the federal government and one-fifth of the tax revenue of provincial governments.

6. A recent trend in federal-provincial fiscal arrangements has been for the federal government to make "tax room" available to the provinces by partially withdrawing from the personal income tax field so that the provinces may increase their participation in this revenue source. The unconditional amount of this "tax room" available to the provinces has been steadily increasing. As of 1967 it was 28

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[1]See Royal Commission on Dominion-Provincial Relations, *Report*, Vol. I, p. 86.

[2]*House of Commons Debates*, July 25, 1917, p. 3765.

per cent of the federal tax plus further percentage points where equivalent further spending responsibilities had been assumed by a province. This trend, coupled with the fact that in an expanding economy the progressive nature of the personal income tax yields revenues that grow more rapidly than those from any other kind of tax, leads to the conclusion that it will in all likelihood account for an even larger proportion of provincial tax revenues in the future.

7. Given its importance as a revenue source to both the federal and the provincial governments, it is imperative that the economic effects of the personal income tax be carefully examined. In the next section of this chapter, we note first its effects on work incentives and on the labour supply, then the impact of the tax on savings and investment, then the incidence of the tax. Finally, we consider the effect of this tax on the distribution of income, on the level of national income, and on the efficiency of resource allocation.

ECONOMIC EFFECTS OF THE PERSONAL INCOME TAX

EFFECTS ON WORK INCENTIVES

8. Possibly the most frequently encountered criticism of the present Canadian tax system is that high and progressive personal income tax rates impair work incentives and thereby generate deleterious effects on economic progress. This argument does not lack plausibility: where taxpayers are paying a high percentage of any additional income to the revenue department, it would seem that they must inevitably find it less and less attractive to work hard. Without hard work on the part of precisely those taxpayers who do encounter high marginal rates, a satisfactory rate of economic progress would seem to be impossible. It is important to examine this criticism with care, for we do not believe that the personal income tax, which has been described as "the outstanding contribution of popular government . . . to modern fiscal practice",[3] can be condemned quite as readily as this argument suggests.

9. By reducing the amount of income that one will forgo if one enjoys more leisure instead of working more, a graduated income tax clearly makes leisure more attractive. It therefore seems logical to conclude that such a tax would encourage people increasingly to prefer leisure over work in comparison with the proportions of each that they would choose with a lesser burden of taxation. This conclusion, however, ignores those effects of the personal income tax that stem from the reduction in disposable income that it occasions.

10. Precisely because the tax does curtail income available for consumption or investment or saving, many taxpayers may be induced to work longer, in order to restore or protect their standard of living. In particular, where the taxpayer is confronted by substantial commitments (for example, mortgage payments, insurance premiums, educational costs for family members), the income tax may exert considerable pressure in the direction of increased work at the expense of leisure. The fact that our enjoyment of the leisure is increasingly tied to our ability to

[3]Henry C. Simons, *Personal Income Taxation*, Chicago: University of Chicago Press, 1938, p. 41.

spend, and so to our income, further militates against any significant tendency to substitute leisure for work. It must also be recognized that much work, especially that part of it which is highly paid, may in itself provide considerable satisfaction and challenge. For these and other reasons, the effect of the tax on work incentives is unpredictable. Some taxpayers may react by working less; others may work more in order to maintain or achieve a desired level of income and standard of living. In any event it is not at all clear that the progressive rates of personal income tax utilized in Canada have had any serious effect on work effort.

11. Theoretical analysis cannot of itself indicate which reaction will predominate. The empirical evidence on the issue, while inconclusive, seems to support the hypothesis that the supply of labour as a whole is relatively insensitive to the present levels of personal income tax rates, so that the tax exerts few significant adverse effects on incentive. In this connection, in 1952, the U.K. Royal Commission on the Taxation of Profits and Income[4] sponsored an investigation into the effects of income tax on industrial workers who were either paid on a piecework basis or to whom overtime opportunities were available. Not surprisingly, most of the respondents complained about the effects of the income tax; few, however, really understood how taxation affected additional earnings, and very few indeed adjusted their behaviour to the existence of the tax.

12. Another survey, also conducted in the United Kingdom,[5] involved the analysis of the effects of the income tax on professional people who were able to vary their work effort. Of the 306 solicitors and accountants included in the analysis, the majority faced marginal tax rates higher than 50 per cent. When the responses that were either "vague" or "questionable" had been rejected, it was found that despite these high marginal rates, approximately 12 per cent of this group of highly tax-conscious respondents had definitely curtailed their professional efforts while another 10 per cent reported a definite propensity to work harder. For the group as a whole it appeared that incentives to work had not been seriously impaired.

13. We cite one further study, which covered 160 business executives in the United States. The author of the study noted that:

> [Despite the executive's] grumbling at the taxes he pays, and his wry allusions to working most of the time for the government rather than for himself . . . his effort is not abated by reason of them; he is still going full blast. So far as any statistical computation has been possible, this fact is attested in a ratio of ten to one as against any other view; and with one small group saying that taxes drive the executive to harder work, and another small group giving examples of some relaxing of effort, these views practically cancelled each other out.[6]

14. To repeat, the available empirical evidence, which covers the tax responses of various types of labour, provides no clear indication that taxation, within the

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[4] Royal Commission on the Taxation of Profits and Income, *Second Report*, Cmd. 9105, London: H.M.S.O., 1954, pp. 91-124.

[5] G. F. Break, "Income Taxes and Incentives to Work: An Empirical Study", *American Economic Review*, Vol. XLVII (1957), p. 529.

[6] Thomas H. Sanders, *Effects of Taxation on Executives*, Boston: Harvard University School of Business Administration, 1951, p. 17.

range of rates within which personal income tax has actually been used in the post-war period, exerts any significant effect on work incentives. A highly vocal dislike for the income tax has become a socially acceptable attitude, but the oft-repeated warnings about the dire consequences of its impairment of work incentives would seem to be difficult to substantiate.

EFFECTS ON THE SUPPLY OF CAPITAL AND ON INVESTMENT

15. The personal income tax affects both the ability and the incentive of taxpayers to save. With regard to incentive, it is apparent that the tax lowers the net rate of return on current saving. It therefore discriminates in favour of present consumption and against saving, and tends to produce a substitution effect unfavourable to investment. Acting somewhat to offset this tendency is the income effect of the tax. Just as the personal income tax may lead to increased work effort in an attempt to maintain one's level of income, so there is a tendency for it to cause those who are heavily dependent upon investment income to save and to increase their investment income in an attempt to maintain personal income and standards of living. Which of these two tendencies, the substitution effect or the income effect, will predominate cannot be determined on theoretical grounds.

16. Much of the discussion of the adverse effects of the personal income tax on saving emphasizes not the adverse effect of the tax on *incentives* to save, but rather its effect upon the taxpayers' *capacity* to save. Certainly after the payment of income taxes individuals do have less left out of which to save, but the significance of this argument can easily be overestimated. With the recent development of fiscal techniques as a tool of economic policy, one major purpose of taxation has become the removal of purchasing power from the private sector of the economy for purposes of stability. Any other tax of equal yield would remove the same amount of resources from the private sector and would also tend to decrease private saving. The net difference, in the effect upon savings, of two equal-yield taxes would thus be limited to the extent to which one or other of them impinges more severely on those taxpayers who are most disposed to save. On this score, the income tax is frequently subjected to excessively severe criticism. A recent quantitative investigation conducted in the United States for The Commission on Money and Credit, which examined the savings-sensitivity of various taxes, concluded that "estate and corporation taxes are highly savings-intensive, followed by the individual income tax and sales taxes. The first two differ sharply, in savings-intensity, from the latter two. By comparison, the difference between the individual income tax and sales taxes is rather minor."[7]

17. Where the interaction of the effects of the personal income tax on the incentives and capacity to save results in a reduction in personal saving, the supply of loanable funds available for investment purposes will be adversely affected. Other factors remaining the same, this would raise the rate of interest and, to the extent that investment is inversely related to the level of the rate of interest, curtail

[7] Richard A. Musgrave, "Effects of Tax Policy on Private Capital Formation", in *Fiscal and Debt Management Policies,* Englewood Cliffs: Prentice-Hall, for the Commission on Money and Credit, 1963, p. 66.

investment. It should be noted, however, that the supply of finance capital is additionally affected by the monetary policies of the Bank of Canada. If this institution is committed at any given point in time to the maintenance of a given interest rate structure, any tendency on the part of the income tax to reduce the supply of finance capital, and thereby to raise the rate of interest, could be offset by appropriate monetary action to alter the volume of bank credit.

18. An issue distinct from that of the effects of the personal income tax on the incentive and capacity of individuals to save is the effect of the tax upon incentive to invest. It is frequently argued that the prospect of high yield is necessary if investors are to be induced to invest in risky ventures. Since the income tax reduces the monetary return from investments, while leaving the risk factor unchanged, it is concluded that, in the eyes of the investor, income taxation narrows the difference between high- and low-yield investments. This seeming bias against venturesome investments is then held to be damaging to economic progress. The major defect in this argument is its assumption that the income tax affects the yield of an investment but not its risk. If there were provision for offsetting the *full* amount of any loss, including capital loss, then the tax would reduce privately assumed risks in the same proportion as yields. In consequence, the gain per unit of risk assumed would be unaffected by the tax. Although the Canadian tax structure does not at present provide for full offsets, it does permit some losses to be deducted from other income, and business losses to be carried backward and forward to prior and future years. This tendency toward the maintenance of yield per unit of risk assumed, coupled with the adverse effect of the tax upon income, could serve to cause some investors to assume more risk than they might otherwise be disposed to do, in an attempt to maintain income levels.

19. Attempts have been made to resolve empirically the inconclusive results yielded by the theoretical analysis of this issue. Possibly the most extensive of these was the 1949 investigation conducted by a Harvard Business School research group, which interviewed more than 700 U.S. investors, most of whom had large incomes.[8] Among the most important of the conclusions yielded by this investigation were the following: (a) over two-thirds of the investors interviewed reported no tax influence on their investment decision; (b) of those who were affected in some way by taxation, those who shifted toward more conservative portfolios outnumbered those who moved in the direction of increased risk by more than two to one;[9] (c) tax effects were strongly related to the size of the income, being more frequently encountered among high- than low-income investors; (d) the net supply of funds for new ventures was probably increased, as attempts were made to take advantage of the favourable tax treatment accorded capital gains.[10]

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[8]J. Keith Butters, Lawrence E. Thompson, and Lynn L. Bollinger, *Effects of Taxation: Investment by Individuals*, Boston: Graduate School of Business Administration, Harvard University, 1953.

[9]It was impossible to establish how much of this movement toward more conservative investments was attributable to the fact and nature of the personal income tax, and how much to the non-taxation of interest from state and local bonds, the favourable tax treatment of permanent investment in life insurance, etc. These other features of the United States tax structure were undoubtedly important in this connection.

[10]Butters *et al.*, *Effects of Taxation*, pp. 36-43.

20. To the extent that the results yielded by the Harvard study are representative, and given the similarity between the U.S. and Canadian tax law, they would seem to support the theoretical case that the adverse effects of the personal income tax upon saving and investment are probably not substantial.[11] Where adverse effects do emerge, it should be emphasized that their impact can be minimized by appropriate monetary policy.

EFFECTS ON THE ALLOCATION OF LABOUR AMONG EMPLOYMENTS

21. Although the total supply of labour does not appear to be particularly sensitive to the personal income tax, the allocation of labour among particular employments may be significantly influenced by tax considerations. As a general proposition, it appears reasonable to expect that if the non-monetary attractions of different occupations are the same, or if any differences in them may safely be ignored, new entrants to the labour force will tend to flow toward those occupations that are subject to relatively light taxation. Conversely, occupations whose rewards experience relatively severe taxation will tend to attract fewer new entrants. These tax-induced effects on relative factor supplies will undoubtedly be much more significant than those arising from occupational shifts on the part of workers already well established in particular areas of employment. For this latter group, the difficulties of acquiring necessary new skills, the losses arising from the abandonment of skills already possessed and losses stemming from the surrender of seniority all suggest that tax-induced occupational adjustments by established workers are likely to be insignificant.

22. All tax-induced adjustments in factor supplies are predicated upon the assumption that the personal income tax strikes different occupations with unequal severity. Although the same rate structure is applied to income from all occupations, differences will exist with respect to such matters as the degree to which necessary expenses are deductible in calculating taxable income, the regularity of the income earnings—a variable with important tax implications where a progressive tax structure is applied—the ease of tax enforcement, and, as already suggested, the relative importance of financial and non-financial—and hence taxable and non-taxable—advantages associated with various occupations.

23. In connection with these occupational tax differentials, it is of some interest to note that while virtually all expenses associated with investment in physical capital are deductible under Canadian tax law, the costs of training and education, i.e., of investment in human capital, are not so deductible. As a result, the advantages of entering those highly paid occupations that require long periods of education and training are reduced.

24. While tax considerations may therefore influence the allocation of labour among various occupations, the significance of their effect should not be exaggerated. In particular, the tax implications of different employments are not widely

[11]The special provisions of the Canadian Income Tax Act that allow deductions from income of individuals for contributions to registered pension plans and registered retirement savings plans tend to mitigate any adverse effects upon, and indeed result in a stimulus to, saving in Canada.

appreciated at the time that career choices are made. Moreover—and this is probably a much more important point—net rates of return are only one component of the complex of factors that typically influence career choices. The weight given to these factors will vary widely among individuals, but we have seen no evidence to suggest that the tax influences are of major significance.

THE INCIDENCE OF THE PERSONAL INCOME TAX

25. It is usually assumed that the monetary burden of the personal income tax rests on the taxpayer. Given the generality of the tax, this assumption is probably as satisfactory as any other that can be made, but the tax-occasioned adjustments in factor supplies (labour and capital) noted above and in prices may result in some shifting of the burden of the tax, shifting being said to occur when adjustments to the tax restore the real incomes of some taxpayers, while reducing those of others.

26. Individual business entrepreneurs may attempt to recoup their taxes by increasing their prices (market conditions permitting), thus shifting their burden to consumers. Employees too may engage in individual or collective bargaining to increase their salaries or wages in an effort to offset their loss in take-home pay occasioned by the tax, thereby causing an increase in production costs with a concomitant increase in prices. But the forward shifting of the tax burden occasioned by both these situations would result in part of the burden returning to rest on entrepreneurs and employees in their role as consumers. In these circumstances, those persons unable to shift any part of their tax would not only bear its burden but also the part shifted forward by others into prices.

27. Again shifting may occur, for example, where the effect of the tax is to reduce the supply of labour. Other things being equal, this would tend to raise wages, thereby in the first instance shifting part of the burden to employers. Where a permissive monetary policy is pursued, these higher wage costs would again tend to be reflected in higher prices, thus burdening others, including, in part, the workers themselves in their role as consumers. Not all labour supplies would, of course, be reduced to the same extent and not all commodities are equally dependent, in their production, on the use of labour. In consequence, relative commodity prices would tend to change, with the greatest burdens accruing to the consumers of those commodities whose prices had risen most. It is also possible, as noted above, that the effect of the tax would be to increase the supply of labour. This would tend to lower wages and prices, the lower prices tending to benefit those persons initially burdened by the tax and others as well.

28. Some shifting is also possible with respect to the income tax on income derived from capital. Should the net effect of the tax result in a decrease in the supply of capital, the rate of interest would (unless offset by an appropriate monetary policy) tend to rise, shifting part of the burden of the tax from lenders to borrowers. Relative capital flows may also be affected by the tax, especially where the treatment of different types of income derived from capital is not uniform. Thus those areas that are likely to generate tax-free capital gains, or that enjoy special

privileges such as depletion allowances, are likely to experience a relative increase in capital flow. Rates of return on different types of investment are thus likely to be affected, and price changes may also be occasioned, these also affecting the distribution of the tax burden.

29. In addition to possible shifting as a result of alterations in the supplies of labour and capital, some further alteration in the distribution of the burden may occur as a result of the tax-occasioned reduction of the demand for these factors by the private sector. While any other tax of equal yield would have similar effects, the actual pattern of demand reduction would tend to differ. To the extent that this tax impinges relatively heavily upon the recipients of higher incomes, the products consumed by these groups will suffer adverse demand effects, thereby reducing the demand for the specialized factors used in their production, with possible adverse effects upon their earnings. Other forms of taxation would nevertheless tend to have similar effects upon other factors of production.

30. While by no means comprehensive, the foregoing discussion serves to indicate that some shifting of the personal income tax may occur, but neither the available evidence nor the present state of economic analysis serves to permit a precise statement about the nature of the shifting that does occur. We have concluded, therefore, that the best single assumption that we can make is that the personal income tax is not shifted, that the burden of the tax rests upon the person on whom it is levied.

OTHER ECONOMIC EFFECTS OF THE PERSONAL INCOME TAX

31. Although the economic ramifications of the personal income tax extend throughout the entire economy, the remaining areas of its impact that we wish to note are its effects upon the distribution of income, the level of national income, and the efficiency of resource allocation. Regarding the first of these, much of the popular support for this tax is derived from the belief that its progressive rate structure either reduces economic inequality or at least checks its growth. However, the redistributive effect is probably appreciably smaller than is commonly believed. Several factors account for the exaggerated impression of the extent of income redistribution brought about by the tax. In the first place, the tax is less progressive than it is usually believed to be, the effective rates upon very high incomes being much lower than the statutory rates would indicate. This is especially true if tax-free capital gains and other tax-free amounts are taken into consideration as a component of income. In the second place, the tax is redistributive only as between groups with effective rates higher and lower than the effective rate for all taxpayers. Relatively few taxpayers have effective rates that are above the average.[12]

32. In addition to its effect in changing a given income distribution, it is certainly conceivable that the income tax may alter the before-tax distribution of

[12]Our staff has made detailed calculations in this area by comparing for the various income-size classes the percentage shares of total Taxable Income Assessed, which sums were then adjusted for total taxes paid and credits claimed. *Cf. 1965 Taxation Statistics*. Part I, Ottawa: Queen's Printer, 1965, Table 2.

income. It may lessen the inequality of before-tax income, for example, if it reduces savings and wealth accumulation on the part of high-income individuals or if it induces them to shift their investment portfolios toward more conservative, lower-yield investments. Conversely, it may increase the inequality of the before-tax income distribution if it induces compensating upward rises in the wages of select employees and in executive salaries and bonuses, professional fees, etc. The available evidence tends to the conclusion that the redistributive effect of the tax has not been entirely offset by changes in before-tax income shares. In consequence, it has probably contributed a positive, though modest, influence in lessening the inequality of disposable income.

33. To focus on the incidence of any one tax—or indeed of all taxes—is necessarily to provide an incomplete picture of the redistributive mechanism. It is clearly also essential to look at the benefits that taxpayers derive from governmental expenditures. As pointed out in Chapter 5, on the incidence of government revenue and expenditure, it is evident that the programs of all levels of government produce a substantial redistribution of income. Because the federal government derives a relatively larger share of its tax revenues from income taxation than do the provinces and because social welfare programs loom large among its expenditures, its fiscal activities effect the greatest redistribution of income within Canada. But as indicated earlier, the provinces are becoming increasingly important in the personal income tax field and their expenditure requirements are growing more rapidly than those of the federal government. Thus they will increasingly influence the distribution of income and services through their own tax and expenditure policies.

34. Turning now to the effect of the personal income tax on the level of production and income, it is apparent that to the extent the tax alters the supplies of labour and capital, it will also influence aggregate output. Should the tax result in a net reduction in the quantities of either or both of these factors, aggregate output would be reduced. On the other hand, a tax-induced net increase in their supplies would tend to raise output levels. Whatever the cost of the tax in terms of output changes, there is the additional cost associated with changes in the balance between leisure and work when the tax disrupts an optimal relationship. It is, of course, a moot question whether the optimal relationship between labour and leisure would be achieved in the absence of the tax.

35. It is also through its effects on the supplies of labour and capital that the tax influences resource allocation. Where the distribution of these factors is altered, the relative costs of producing different commodities will be affected, and if the pattern of demand for goods and services remains unchanged, this will change their relative outputs. If the tax were imposed under conditions in which the allocation of resources and the output of the economy were already optimal, such changes would represent undesirable distortions. Since the market mechanism rarely operates to produce optimal results, one cannot be certain that the distortions occasioned by the tax are in fact undesirable.

CONSTITUTIONAL ASPECTS OF PROVINCIAL INCOME TAXES

36. Any study of the constitutional aspects of provincial legislation currently imposing personal income tax must begin with an examination of Section 92(2) of the British North America Act which limits the provincial taxing power to "Direct Taxation within the Province in order to the raising of a Revenue for Provincial Purposes". In addition, the legal bases for a delegation of legislative and administrative powers must be examined. Our staff studies have led us to conclude that the income taxes levied, and the manner in which they are levied, meet the constitutional requirements. The following are the summary reasons:

(1) An income tax is a direct tax because it is imposed on the persons whom the taxing authority intends to pay it.

(2) The provinces' right to tax persons "within the Province" means that

 (a) a Province may tax any person if he is found within the province, whether he is domiciled or resident there or not, and any person who carries on a business in a province through a branch or even through salesmen or agents is "within the Province"; and

 (b) an income tax in respect of total world income, including any from extra-provincial sources, imposed upon a person found to be within the province is within the ambit of a Province's taxing power.

(3) A tax rental agreement is a constitutional delegation of legislative functions by a Province.

(4) A provincial taxing statute may incorporate by reference valid existing legislation of the Canadian Parliament, plus any future amendments to that legislation.

(5) Executive or administrative power may be delegated by a provincial legislature to a federal official or by the Canadian Parliament to a provincial official.

THE HISTORY OF THE PERSONAL INCOME TAX IN ONTARIO

MUNICIPAL INCOME TAXATION

37. In Chapter 10, in which we discuss the history of property taxes and their present use in Ontario, we have detailed the evolution of municipal personal income taxation in Ontario because from 1850 to 1904 this tax was imposed as part of the personal property tax in the province.

38. The Assessment Act of 1904 eliminated the personal property tax and made mandatory the levying of a municipal personal income tax on all residents of the municipality. Divorced from its parentage, personal income at that time became, if not directly taxable, at least a supplement to the property tax and the newly enacted business tax, and available to municipalities as an additional revenue source.

39. The Assessment Act of 1904 defined income for the first time. Generally speaking, it followed the United Kingdom pattern of attempting to separate the fruit from the tree, bringing annual accretions within the ambit of the tax but leaving a person's capital intact. Exempted from the tax were: (1) income from

farming and real estate (except interest on mortgages) and (2) dividends from taxable corporations, including dividends from shares in toll-road companies. The latter exemption represented an attempt to avoid what was considered double taxation of the same income—i.e., of both the company and its shareholders.

40. The Act also introduced a system of personal exemptions, applicable to employment income only, graduated to give the greatest deduction from salaries to a householder living in a city or town, with diminishing graduated deductions to householders living in other municipalities, non-householders living in cities or towns and, finally, non-householders living in other municipalities.

41. The 1904 Act made, for that time, great strides toward effecting tax compliance. Given the ethos that considered any government attempt at verification of a taxpayer's self-assessment as inquisitorial[13] and an invasion of privacy, the legislation to a limited extent successfully challenged this bias by providing for the filing of information returns. Employers were required to furnish municipalities with information concerning their payrolls, and dividends and bonuses paid to shareholders. Non-compliance was subject to a penalty. In addition, persons liable to business assessment and having no income from sources other than their business were exempted from the personal income tax. The provisions governing professional men were somewhat more complicated. If the professional income was not in excess of the business assessment, no income tax was payable, the professional man being called upon to pay only his business assessment. If, however, his income from his calling exceeded his business assessment, he was required to pay only income tax. In this manner, in the opinion of a contemporary commentator,[14] a sizeable portion of the business and professional community was relieved of the exigencies of self-assessment and subjected instead to a fixed basis of assessment. Only income derived from investments and from sources outside the province remained dependent on taxpayer compliance if it was to bear any income tax.

42. Municipal income taxes continued in effect in Ontario until 1936, and during all those years their yield remained small. Given the intrinsic growth potential of the tax, this is a startling fact. The explanation is prosaic enough: too narrow a base and, all too frequently, ineffectual local administration.[15]

43. The personal exemptions had been raised continuously from 1904 onward, until by 1930, $3,000 of householders' incomes and $1,500 of non-householders' incomes were exempt from tax. Persons over 60 years of age and all widows were entitled to the $3,000 exemption. The exemption for each dependent child or parent was $400. In 1929 the average per-capita income of Canadians was only $459, and that of Ontario residents $562. The average income per employed person in the non-agricultural labour force of Canada in that year was about $1,400. While we do not have the comparable figure for the Ontario non-agricultural labour

[13]Solomon Vineberg, *Provincial and Local Taxation in Canada*, New York: Columbia University, 1912, p. 58.

[14]*Ibid.*, pp. 64-6.

[15]The description that follows is based on Robert M. Clark, *Some Aspects of the Development of the Personal Income Tax in the Provinces and Municipalities of Canada up to 1930*, unpublished Ph.D. thesis, Harvard University, 1946.

force, it is readily apparent that, given the size of the personal exemptions, only a relatively small proportion of income earners were subject to the tax at all, even assuming that average income in Ontario was considerably higher than the national average.

44. Second, the tax was unevenly administered throughout the province. In spite of the clear direction of The Assessment Act requiring every municipality to assess the income of its residents, many rural and small urban areas ignored these provisions altogether. Many people with large incomes were quick to avail themselves of these lax conditions once they became known, with the result that many colonies of the relatively rich sprang up in these tax-haven jurisdictions. In many municipalities where income tax assessment was practised, it virtually became a tax on wage and salary earners, most recipients of investment income or professional fees being almost entirely exempt or grossly under-assessed. Frequently, misdirected economy prevented efficient tax administration and collection, while in many smaller municipalities local politics were responsible for the poor results.

45. It must also be borne in mind that income taxes assessed one year were payable the following year. The pay-as-you-go collection of income tax remained to be introduced by the federal government during World War II as a means of financing the war effort. No Ontario municipality had the advantage of source-withholding of tax from salaries and wages, or of current quarterly instalment remittances of tax from those taxpayers not in receipt of salaries and wages. It is probable that even where assessment procedures were well developed, collection of the assessed tax presented problems.

46. Not all Ontario municipalities were equally deficient. The City of Toronto had developed an efficient income tax administration consisting of a special income tax branch of its Assessment Department. To it, employers were required to send the names, addresses and remuneration of employees, and companies were required to furnish similar information regarding dividends paid to shareholders subject to the tax imposed by the City. Registry offices and surrogate court records were investigated for information relating to mortgage income, bequests and devises. In 1930 some 23,900 individuals were subject to personal income tax on $68.3 million in Toronto. In that year, total income assessment constituted 8.11 per cent of the city's total taxable assessment.

47. During the decade of the twenties the income tax assessment as a percentage of total taxable assessment in those Ontario cities that were seriously imposing personal income taxes was as follows:

	Average 1920-30
Toronto	7.95
Ottawa	8.09
London	6.50
Hamilton	5.70
Brantford	5.63
Kitchener	4.98

48. While the foregoing discussion points up the consequences of a non-uniform assessment of income in the municipalities of the province, consequences that included regressiveness, inequity and low yield, it was becoming increasingly obvious that municipal income taxation was subject to a more basic and overriding criticism. The comprehensive nature of an income tax required a jurisdiction much larger than any single municipality if its progressive rate structure was to accomplish in practice what its theorists had long been maintaining to be possible—high revenue yields from a tax based on ability to pay. In addition, the practical evidence derived from the larger territorial areas already levying personal income taxes—i.e., the federal government, British Columbia, Prince Edward Island, Manitoba, Alberta and Saskatchewan—must have emphasized the benefits to be derived from an expanded jurisdiction.

49. When the depression of the 1930's forced Ontario to seek new revenue sources to meet its pressing needs, it was perhaps inevitable that it should take over the occupancy of the personal income tax field, thus providing a sufficiently large geographical base for the efficient functioning of the tax and minimizing the inequalities and inequities of non-uniformly imposed or administered municipal taxes. In 1936 the Province enacted its first Income Tax Act, repealed the right of municipalities to levy personal income taxes, and replaced these local revenues with grants to the municipalities. However justified in theory and practice this move might have been, it did deprive the municipalities of access to what has subsequently proved to be a very productive source of revenue. Its effect on municipal revenues is discussed in detail in Chapter 10.

INCOME TAX ACT, 1936

50. The Ontario Income Tax Act of 1936 closely paralleled the federal Income War Tax Act, 1917. It imposed rates at one-half of those in effect in that year under the federal Act and on virtually the same base. Cognizant of the unpopularity of subjecting the same income to tax in more than one jurisdiction, it provided some relief from "double taxation" by permitting a deduction of the federal tax payable from income for provincial tax purposes.

51. Ontario was the first province to conclude an agreement with the central government under which the federal Department of National Revenue administered and actually collected the tax imposed by Ontario, and then remitted the proceeds (less a fixed fee) to the Province. Because the two Acts were almost identical, a single form for computing both taxes was filed by Ontario taxpayers with the federal Department of National Revenue. The arrangement obviated the need for a costly separate provincial administration and collection apparatus and no doubt produced more revenue than could have been anticipated from any new and inexperienced collection department. The collection agreement negotiated between Ontario and Ottawa in 1936 was the prototype for three other federal-provincial agreements entered into shortly thereafter to facilitate administration and collection of provincial income taxes—Prince Edward Island and Manitoba in 1938, and Quebec in 1940. These arrangements remained in force from 1936 to 1942 when all provincial personal income tax Acts, including the Ontario Income Tax

Act, 1936, were suspended by the Wartime Tax Agreements of 1942, although collections of delinquent taxes under the suspended statutes for prior years continued to be made after 1942 under the earlier agreements.

WARTIME TAX AGREEMENTS

52. The costs of financing World War II demanded at least a temporary realignment of taxing powers within Canada. Federal income tax rates rose to unprecedented heights, and the Honourable J. L. Ilsley, then federal Minister of Finance, was aware that if the other levels of government were to continue their own levies at their diverse rates, the combined burden and the inequities of income taxation would become unbearable. The solution was to have the provinces vacate certain tax fields and receive agreed compensation from the federal treasury. Thus for the duration of the war and the year following, all the provinces (and their municipalities) relinquished their right to impose personal and corporate income taxes, including corporation taxes; and in return the provinces received annual payments made up of tax reimbursement grants, existing statutory subsidies and, where proved, fiscal need subsidies and payments for the loss of any gasoline revenues occasioned by war-time gasoline rationing. The Wartime Tax Agreements covered the six-year period beginning with the province's fiscal year that ended nearest to December 31, 1941 and terminated with the fiscal year that ended nearest to December 31, 1946. The suspension covered Ontario's 1942 to 1947 fiscal years, the six-year period from April 1, 1941, to March 31, 1947.

TAX RENTAL AGREEMENTS

53. The experience of the Wartime Tax Agreements convinced the federal government that a continuation of the general arrangements would be beneficial for the immediate post-war period. After the Conference on Reconstruction came to nought and several subsequent offers had been rejected, the federal government finally offered the provinces new compensation proposals for a five-year period, based on two general formulas, either of which a province might choose at its option, in return for its vacating the personal income, corporation and inheritance tax fields. The provinces were to levy uniform 5 per cent corporate income taxes which would be administered by the federal government and which would be eligible for a 5 per cent provincial corporation income tax credit from federal income tax —in effect, a tax-sharing arrangement. Seven of the then nine provinces entered into tax rental agreements with the federal government during 1947 and 1948; but the two largest provinces, Ontario and Quebec, remained aloof. Newfoundland, on entering Confederation in 1949, signed a similar agreement.

54. Under the tax rental agreements, the provincial governments that signed agreed not to levy certain taxes and in return received compensation from the federal government. The compensation formula provided for guaranteed minimum payments and adjustment payments, based on population and gross national product. These arrangements were models of administrative simplicity, and economical for both taxpayers and provincial governments alike. They incorporated in embryonic form the fiscal ideals of stabilization of provincial revenue and interprovincial

revenue equalization. But they suffered from serious drawbacks. (1) Once a government rented out its taxes it gave up control over the tax base and the rates, if not for the duration of the agreement then until a new bargain could be struck; (2) the taxpayer was frequently completely unaware of the ultimate destination of the taxes he paid since only the federal parliament legislated taxes and raised revenues; (3) the equalization measures were rudimentary in the extreme; (4) in emphasizing stability of revenues, their elasticities were neglected; and (5) the position of a non-agreeing province was anomalous and a potential source of trouble.

55. Not having entered into the 1947 tax rental agreement, Ontario was free to reimpose its pre-war taxes. It moved in this direction by (1) imposing a 7 per cent corporate income tax which was partially offset by the 5 per cent provincial corporate income tax credit, (2) imposing corporation taxes on places of business and paid-up capital, and (3) continuing to impose succession duties, which then became subject to a credit against the federal succession duties coincidental with the enactment of new rates approximately double the Ontario rates. It did not, however, revive the personal income tax even though the federal government offered a credit of 5 per cent of the federal tax for personal income taxes paid to a province not a party to the agreement. In 1950 Ontario sought to avail itself of this statutory tax-sharing gesture by enacting a personal income tax of 5 per cent of the federal tax payable and by authorizing the negotiation of a tax collection agreement with the federal government. Because that government refused to collect the tax on Ontario's behalf, and since the Province had no machinery for collecting the tax itself, the legislation was never proclaimed. Yet Ontario received no compensation even though it had refrained from levying personal income taxes during the life of the agreement.

56. Federal-provincial tax rental agreements were re-negotiated for a second five-year term to cover the 1953 to 1957 fiscal years—i.e., the period from April 1, 1952 to March 31, 1957. The eight provinces that had been parties to the earlier agreement signed for this further five-year period. Although Ontario initially evidenced considerable reluctance to accept the terms of the new agreement, it did by August 1952 accede to the tax rental scheme when a new option offered by Ottawa was more to its liking, giving greater cognizance to tax capacity. It became the ninth province to enter into an agreement with the federal government, with only Quebec staying out.

57. Under this agreement, Ontario rented to the federal government the personal and corporate income tax and corporation tax fields, but continued to impose succession duties for which the federal Succession Duties Act provided a tax credit —compensation under the agreement being reduced accordingly.

TAX-SHARING ARRANGEMENTS

58. Although the subsequent federal-provincial fiscal arrangements for the period April 1, 1957, to March 31, 1962, were designated as tax-sharing agreements, they revealed both a similarity to the predecessor tax rental agreements and a portent of the future.

59. The federal-provincial tax-sharing agreement of 1957 provided that as compensation for not levying the designated taxes, the agreeing provinces would receive tax rental payments equal to: (1) 10 per cent of federal personal income tax collections in the province; (2) 9 per cent of a corporation's taxable income earned in the province, and (3) 50 per cent of federal death taxes attributable to the province. For the first time, rental payments to a province varied directly with the yield from that territorial source, thus explicitly recognizing a growth factor. In addition, every province so entitled, whether a signatory to an agreement or not, received tax equalization and stabilization payments on a much more sophisticated basis than previous agreements had provided.

60. For any province that did not enter into an agreement, the federal government provided tax credits at the same rate—i.e., 10 per cent of the federal tax payable by individuals on income earned in the province, 9 per cent of a corporation's taxable income earned in the province, and 50 per cent of federal death taxes attributable to the province. The anomalous position of any non-agreeing province was thereby eliminated.

61. Ontario signed an agreement with respect to personal income taxes only, reintroduced corporate income and corporation taxes and continued to impose succession duties, as it had done under the previous tax rental agreement. Once again eight provinces rented out all three taxes to the federal government and Quebec continued to levy its own.

62. Following a conference held in November 1957, the rental payment for personal income tax was raised to 13 per cent from 10 per cent for the remainder of the agreement, as was the tax credit available to taxpayers of a non-agreeing province.

63. A further feature of this period was the first successful solution to the problem of a province's contracting out of a federal program without suffering a financial penalty. Although federal funds for universities had first been made available in 1951, Quebec refused to participate in the program on the grounds that it represented an invasion of provincial autonomy. In 1960 the federal Income Tax Act was amended to provide that corporate taxpayers of Quebec would receive an additional credit of 1 percentage point—i.e., 10 per cent rather than 9 per cent—against their federal corporate income tax payable, in lieu of university grants to that Province. This enabled Quebec to increase its corporate income tax levy by 1 percentage point without increasing the net burden of taxation on Quebec corporations.

FEDERAL-PROVINCIAL FISCAL ARRANGEMENTS

64. The terms of agreement, as incorporated in the Federal-Provincial Fiscal Arrangements Act of 1961, covering the five fiscal years from April 1, 1962, to March 31, 1967, witnessed the final evolution from a tax rental to a tax-sharing arrangement for personal and corporate income taxes. Death taxes did not follow this pattern because in 1958 the federal government had enacted an estate tax (an

indirect tax) in place of its earlier succession duty (a direct tax). Since the provinces for constitutional reasons may impose only direct taxes, the bases could not be made uniform, and the federal government therefore continued to rent this field from those provinces not imposing a succession duty. Equalization grants were negotiated on a revised basis, but the provincial revenue stabilization provisions were the same as those in the 1957 agreements.

65. Under this system for federal-provincial tax sharing, both governments must impose a tax on an agreed tax base. The rates may be varied by either government as it sees fit.

66. By permitting an abatement from federal tax payable for taxes paid to a province, the federal government is providing "tax room" for the provinces, since they are expected to impose a tax at a rate at least equal to the federal abatement. This might best be described as a sharing of tax yields.

67. When only the federal government collects the tax for the agreeing provinces, a tax-sharing agreement is similar in many respects to a tax rental arrangement, but it has the advantage of permitting a province to vary its rates, of bringing home to taxpayers the rates being levied by the various governments, of returning to the provinces the responsibility for legislating their own taxes and of eliminating the discrimination against provinces that do not sign an agreement.

68. Under the Federal-Provincial Fiscal Arrangements Act of 1961, the provinces were required to legislate their own personal and corporate income taxes. The federal government provided tax room for the provinces by permitting abatements from its taxes in 1962, of 16 per cent (rising annually by 1 percentage point to 20 per cent by 1966) of personal income tax payable, and 9 per cent of corporate taxable income. In effect, it withdrew from the personal and corporate income tax fields to the extent indicated by the rate of the abatement.

69. Provided the bases of these provincial taxes were the same as the federal ones, the central government would administer their Acts and collect their taxes free of charge. The provinces were at liberty to impose any rate of tax that they wished. This arrangement made it possible for each taxpayer in the agreeing provinces to file a single tax return with the federal tax department for both the federal tax and the provincial tax.

70. The abatement was available to taxpayers in all provinces whether a province chose to accept the federal collection offer or to administer its own Acts and collect its own taxes directly.

71. The federal government continued to rent the succession duty field from the provinces and returned 50 per cent of its estate tax yield to each province that did not impose succession duties. For those provinces that imposed their own succession duties (in 1962, Ontario and Quebec) the federal government provided a provincial tax credit of 50 per cent against the federal estate tax payable.

72. From the outset, both Manitoba and Saskatchewan took advantage of the greater flexibility of the fiscal arrangements and imposed personal income tax rates

that were 6 percentage points higher than the abatement, that is, 22 per cent of the federal personal income tax in 1962 (again rising by 1 percentage point until 26 per cent was reached in 1966) and corporate income tax at the rate of 10 per cent of taxable income, a rate that was 1 percentage point higher than the abatement. Quebec enacted a progressive personal rate schedule that was roughly equivalent to the amount of the federal abatement and a corporate income tax rate of 12 per cent of taxable income, this being 2 percentage points higher than the 10 per cent abatement allowed to companies on their taxable income earned in Quebec. All the other provinces imposed personal income tax rates equal to the amount of the abatement, and of these all but Ontario's corporate tax rate was equal to the federal abatement of 9 per cent of taxable income, for corporate income tax paid to the Province. Ontario's corporate income tax rate was 11 per cent—2 percentage points higher than the rate of abatement. Not having signed an agreement with respect to corporate income tax, Ontario continued to administer and collect the tax itself.

73. The arrangements negotiated in 1961 have proved to be highly flexible, capable of responding in some degree to the needs of the provinces for additional revenue, and of accommodating changes in the division of taxing jurisdictions and the methods of financing expenditure programs. Thus, when in 1963 British Columbia re-entered the succession duty field, the provincial tax credit against federal estate taxes was available to British Columbia taxpayers. In November 1963 a federal-provincial conference negotiated an increase in the provinces' share of the death tax yield from 50 to 75 per cent, effective from April 1, 1964, the increase to be accomplished either by increased rental payments or an increased tax credit. The same conference also effected a revision of the equalization formula. Further federal-provincial negotiations in the spring of 1964 resulted in a further withdrawal by the federal government in favour of the provinces from the personal income tax field, when the federal abatement was raised from 19 to 21 per cent for 1965 and from 20 to 24 per cent for 1966.

74. Arrangements for provinces to contract out of certain federal or joint-cost programs also made use of the abatement procedure. Thus, since Quebec was already operating a program of youth allowances when Ottawa entered that field as of September 1, 1964, the federal government announced that beginning with 1965, taxpayers of Quebec would be granted an additional abatement of 3 per cent against their federal personal income tax payable. Similarly, in 1965, Quebec was the only province to accept a federal offer of a further personal income tax abatement of 20 percentage points rather than continue certain optional federal-provincial shared-cost programs. The 1964-65 federal Established Programs (Interim Arrangements) Act sets up this opting-out procedure. The rates of personal income tax abatement for Quebec taxes were thus 44 per cent in 1965 and 47 per cent in 1966. In the fall of 1966 the federal government announced its readiness to transfer to the provinces, for 1967 and 1968, an additional 4 equalized points of personal income tax collections and 1 equalized point of the corporation income tax base, in lieu of the present grants to universities and other post-secondary educational institutions to help meet their operating costs.

75. When the provincial share of death tax yields was increased from 50 to 75 per cent as of April 1, 1964, those provinces imposing succession duties were given the option of taking the additional 25 per cent either in the form of an increased tax credit or as a straight cash payment from the federal treasury. British Columbia chose the increased tax credit by raising its rates while both Ontario and Quebec chose the alternative.

76. A far-reaching development of the 1964 federal-provincial conference was the establishment of the Tax Structure Committee. Composed of ministers of both the federal and provincial governments, the Committee was directed to review the problem of the relation between federal and provincial taxes and their expenditure responsibilities.

77. By providing intergovernmental machinery for an exchange of views, it was hoped that federal-provincial relations could be considerably democratized and that the prospect of genuine federal consultation with the provincial governments would be greatly enhanced. Recent events associated with the operation of the federal-provincial Tax Structure Committee have not been reassuring in this respect.

TAX COLLECTION AGREEMENT

78. The latest tax collection agreement in respect of personal income taxes between the governments of Ontario and Canada was negotiated for the five-year period beginning January 1, 1962, and ending December 31, 1966. Although at the time of writing the period covered by this agreement had expired, the collection arrangement has been continued and it is expected that it will again receive statutory confirmation. We shall therefore summarize the provisions of the agreement for the period 1962 to 1966 inclusive.

ADMINISTRATION OF PROVINCIAL ACT BY FEDERAL GOVERNMENT

79. Section 1 of the agreement provides that the personal income tax imposed by Ontario will be collected by the Government of Canada, as agent for the Provincial Treasurer, without charge to the Province. Section 10 of the agreement enables the federal Minister of National Revenue, his Deputy for Taxation and the officials of the Taxation Division of the Department of National Revenue to administer the provincial Act for the Province. To this end, the Province is to ensure that the federal Minister and his officials have the same powers under the provincial statute as they possess under the federal Act. Section 10(4) of the agreement provides that the Province must accept as final and binding all assessments and decisions made by the Minister of National Revenue and his departmental officials in administering the provincial Act.

80. While the federal government generally pays the costs of collecting the provincial tax, section 10(5) of the agreement provides that, except for the penalty imposed for wilful evasion of the tax or for gross negligence in completing a return, all penalties, fines and interest imposed under the provincial Act are to be retained by Canada as compensation for collecting the Ontario tax.

81. The agreement also binds the federal Department of National Revenue to continue assessing and collecting provincial income taxes imposed during the period covered by the agreement after its expiration, as necessitated by a reassessment.

UNIFORMITY OF LEGISLATION

82. In order to facilitate uniform administration of the federal and provincial Acts, the Province is required to impose interest rates and penalties at the same percentages as those imposed under the federal Act. Instalment payments of tax must be in conformity with comparable provisions under the federal Act, both in the manner of making the instalment payment and the period covered, and deductions at source from employees' wages must be in a fixed ratio to the federal deductions. The provisions of the provincial Acts and Regulations governing administration, enforcement and collection must be maintained in a form and with a content similar to the corresponding provisions of the federal Act.

83. The Province must amend its legislation to bring it into conformity with any amendments made to the federal Act or Regulations. When the Minister of National Revenue is of the opinion that the Ontario legislation does not confer sufficient authority on him to collect the provincial tax, or does not admit of sufficient uniformity of administration with the federal Act or with the Acts of the other agreeing provinces, he has the right to require Ontario to amend its Act or Regulations to this end. If the Province does not make the change within six months of the request, the Minister may give notice to terminate the collection agreement, applicable to any year following the year in which notice is given. Alternatively, he is relieved of the responsibility of collecting the provincial tax if he is in doubt that he has the requisite provincial authority.

84. Finally, Section 23 of the agreement explicitly states that the Government of Canada is free to alter or vary its Income Tax Act and Regulations in any way that it sees fit. No prior consultation with Ontario is necessary or even contemplated in the agreement.

BASIS AND RATE OF TAX

85. A basic tenet of the agreement is that the tax base be identical with that of the federal Act. To this end, Section 2 of the agreement provides that the provincial personal income tax rate must be expressed as a constant percentage (in whole percentage points) of the federal tax payable by an individual for the year, and only one rate of personal income tax for each year may be imposed. Section 5 of the agreement further reinforces the identity of the tax base by providing that all persons who are taxable under the federal Act must be taxed by the Province, that all persons exempt from tax under Section 62 of the federal Act will be granted the same exemption by the Province, and that the Province will not impose a withholding tax on certain remittances to non-residents or a gift tax under its Income Tax Act, or under any other statute, during the term of the agreement.

CHANGES IN RATE OF PROVINCIAL TAX

86. The agreement embodies strict rules relating to changes in the Province's tax rate. Should Ontario wish to change its rate, it must advise the Minister of National Revenue by October 1 of any year of the proposed change, the change must be of the order of one or more whole percentage points, and the new rate must go into effect the following January 1. Furthermore, since any change in the federal rates or personal exemptions or dependants' deductions would directly affect the provincial tax base and therefore the Province's yield, it is provided in the agreement that where in any year amendments to the federal Act are announced in the House of Commons that would reduce the effective rate of federal personal income tax by more than 3 per cent, the Province may increase its tax rate for that year to offset its anticipated reduction in revenue, provided the Minister of National Revenue is notified of the proposed increase by October 1 of that year.

APPLICATION OF TAX COLLECTIONS

87. One result of the tax collection arrangement is that a taxpayer is required to discharge his tax liabilities to two or more jurisdictions simultaneously. If all taxpayers paid their taxes promptly in full and never disputed the amount of their tax liability, there would be no need to determine the order of discharge of the taxpayer's liability to the various jurisdictions. In the absence of this tax administrator's utopia, the agreement provides in Section 15 that payments from a taxpayer are to be applied first against his provincial tax liability and any remainder against his federal tax payable. If the taxpayer is subject to tax in two or more agreeing provinces, any payment he makes will be applied *pro rata* in discharge of his provincial liabilities and any remainder against his federal tax.

88. A taxpayer's residence in a province on the last day of the year determines his liability to tax in that province. If he is an employee and has moved from one province to another during the year, tax will have been deducted at source under the authority of two provincial Acts. If he has ceased to be resident in Ontario during the year and resides in another agreeing province on the last day of the year, the agreement provides that the provincial tax withheld from his salary during the period when he was a resident of Ontario will be retained by Canada, and ultimately distributed to the province in which his provincial tax liability rests.

PAYMENTS TO ONTARIO

89. The provisions for the federal government's payment of the taxes collected on Ontario's behalf are in many respects remarkably similar to the method of collecting corporate income tax on a pay-as-you-go basis under the federal Income Tax Act. Thus, under the agreement Canada must remit to Ontario in equal monthly instalments, commencing in April of any year, Canada's estimate of its anticipated provincial tax collections for the calendar year that began the previous January. A statement outlining the method of calculation of the estimate must accompany the first instalment for the year. This initial estimate may be revised upon receipt of more accurate information and the monthly instalments will be adjusted accordingly. Again, just as a corporation must file within a specific period

a return of its actual income earned during its taxation year and make the necessary adjusting payment of any balance still owing, the federal-provincial accounts are adjusted in a similar fashion. On the basis of information available on October 15 from the assessment of taxpayers' returns, Canada must recalculate the amount payable to Ontario for the previous fiscal period and pay any balance owing to the Province by December 31. Since some employees from whom taxes have been withheld at source fail to file returns, the agreement provides that the recalculation include an amount, as determined by the Minister of National Revenue, that represents the amount of unclaimed deductions at source made pursuant to the Ontario Act. Again, this annual adjusting payment must be explained in a statement furnished the Province outlining the method and result of the recalculation. If the recalculation indicates that an overpayment has been made to Ontario, the federal government may recover the excess from any moneys that may become payable to the Province. Since the computation of income tax payments to the provinces is based on the taxes assessed against a taxpayer, and not on the taxes he has actually paid, the Province is in no way affected by a taxpayer's actual delinquency in remitting his provincial taxes.

90. Provision is made for an annual audit by the Provincial Auditor of only those records that are relevant to a verification of the payments made to Ontario in respect of individual income tax and unclaimed provincial deductions at source.

DISPUTES AND DIFFERENCES

91. Should any disputes or differences arise in interpreting the agreements, the matter is to be settled by way of reference to the Ontario Court of Appeal, subject to an appeal to the Supreme Court of Canada. Provision is also made for the termination of the agreement should either party fail to comply with its terms or fail to give effect to the opinion of the Court.

RULES FOR ALLOCATION OF INCOME

92. The tax collection agreement does not itself contain rules for the apportionment of the tax base among the provinces. Rather, it incorporates by reference the rules for allocating personal income to the various provinces as determined by the federal Act and Regulations. To complete our descriptive analysis, we shall now explain these apportionment procedures before going on to an evaluation of the present agreement.

93. Part XXVI of the federal Income Tax Regulations sets out the rules for determining the income earned by an individual in a province. These Regulations were initially promulgated in 1956 to determine the amount of the provincial tax credit that would be allowed against federal income tax payable to a resident of a province that imposed a personal income tax. Its provisions were designed to meet the fiscal arrangements of the period April 1, 1957, to March 31, 1962. The Regulations were extensively amended in 1962 to reflect the tax-sharing arrangements arrived at for the period April 1, 1962, to March 31, 1967. They determine

both the amount of the abatement allowed under the federal Act for provincial taxes, and, under the collection agreements and provincial income tax Acts, the tax liability of an individual to the various provinces. Again, by dovetailing the federal abatement for provincial taxes with the determination of provincial personal income tax liability, integration of the federal and provincial Acts is achieved.

94. We shall now proceed to describe these rules as they affect persons liable for Ontario tax, although the rules are equally applicable to all provincial personal income taxes.

95. Individuals residing in Ontario on the last day of the year, and who have no business income from a permanent establishment outside of Ontario, are taxed by Ontario on their income from all sources, including investment or employment income derived from sources outside of Ontario. Should an individual move to Ontario from another province at any time in the year and be resident in Ontario on the last day of the year, he is subject to tax in Ontario on his world income for the whole year, unless he has business income from a permanent establishment situated outside Ontario.

96. Residents of Ontario who derive business income from a permanent establishment situated outside Ontario are taxed in Ontario on their world income less their extra-provincial business income.

97. Residents of another province or territory of Canada who derive business income from a permanent establishment in Ontario are subject to tax in Ontario on this business income.

98. Part-time residents of Canada, who, while they were resident in Canada, were resident in Ontario on the last day of their Canadian residence, are subject to tax in Ontario on their income from all sources for the period they resided in Canada, less any business income allocable to a permanent establishment outside Ontario. This provision applies equally to an Ontario resident who dies before the end of the year.

99. If an individual is resident in more than one province or territory of Canada on the last day of the taxation year, he is regarded as being resident only in the province or territory that may reasonably be regarded as his principal place of residence.

100. Non-residents of Canada are taxable in Ontario on their business income derived from a permanent establishment located in Ontario and any employment income earned in Ontario.

101. It is readily apparent that these allocation rules are designed first to conform with the constitutional limitation on provincial taxing powers by which the provinces are limited to direct taxation within the province. In addition they ensure that no two provinces will have jurisdiction over the same income. From the taxpayer's point of view, they simplify matters considerably.

ALLOCATION OF BUSINESS INCOME

102. The rules for allocating the business income of individuals as between the provinces, territories, and countries other than Canada are similar to the rules for allocating corporate business income, which are discussed in the chapter on corporation taxes. These rules are summarized in the following paragraphs.

103. Business income of an individual is allocated to only those provinces in which his business is conducted through a permanent establishment. The definition of "permanent establishment" which means a fixed place of business, includes an office, branch, mine, oil well, farm, timber land, factory, workshop or warehouse and is similar to that contained in The Corporations Tax Act of Ontario. Its significance is discussed in the corporations tax chapter.

104. If an individual has a permanent establishment in Ontario and has no permanent establishment outside the province, the whole of his income from carrying on business is attributed to Ontario. If an individual has no permanent establishment in Ontario, none of his business income is attributed to Ontario. If he has permanent establishments both inside and outside Ontario, his business income will be apportioned as between the jurisdictions in which he has permanent establishments. The amount of business income that will be attributed to each jurisdiction is computed according to a formula based on the gross revenue attributable to the permanent establishment and the salaries and wages paid to employees of the permanent establishment in each jurisdiction. The wording of the formula is complicated, but can readily be comprehended when expressed as:

$$\frac{1}{2}\left(\frac{\text{gross revenue in province}}{\text{total gross revenue}} + \frac{\text{salary and wages paid in province}}{\text{total salaries and wages paid}}\right) \times \begin{array}{c}\text{business}\\ \text{income}\end{array}$$

This formula is modified for bus and truck operators, where miles travelled by vehicles are substituted for gross revenue.

105. Because trade can be local, interprovincial or international, with the ultimate destination of a businessman's product being a jurisdiction in which he may or may not have a permanent establishment, the Regulations contain specific rules for determining the permanent establishment to which gross revenue is attributable when merchandise is shipped. Similarly, there are rules for such a determination when business consists of the rendering of services, the selling of standing timber or the right to cut timber, or the leasing of land, when these businesses are carried on in two or more jurisdictions.

106. The determination of the amount of salaries and wages to be assigned to the various permanent establishments is easier to describe. To the total of direct payroll costs must be added the fees paid for services that would normally be performed by employees of the taxpayer. A commission paid to a person who is not in the employ of the taxpayer is not, however, considered a fee. To illustrate, if a manufacturer supplies raw materials and contracts for labour only with another manufacturer, the fee under the contract is considered a labour cost of the first manufacturer.

107. Where an individual operates more than one business, the allocation rules are applied to each business separately and the aggregate of the amounts so determined is the amount of business income earned in the year in a particular province or country.

108. The business income of a part-time resident of Canada is allocated in the same way as that of a full-time resident for the period of the year during which he was carrying on business in Canada. The business income of a non-resident of Canada attributable to a particular province is computed in the same way as the business income earned in a province by a Canadian resident. For a non-resident, however, only income from a business that is wholly carried on in Canada or from that part of his business that is carried on in Canada is subject to allocation for provincial tax purposes. Similarly, his total salaries and wages are limited to the salaries and wages paid to employees of his permanent establishments in Canada, and his total gross revenue is limited to his total gross revenue reasonably attributable to his permanent establishments in Canada.

109. It is possible that under the allocation rules an individual's income earned in a province may exceed his income from all sources for the year. As an example, he might have carried on two or more different businesses in two or more different provinces and suffered losses in one of them. In such circumstances, a formula is provided that distributes the loss from the one business among the incomes derived from the other businesses, as allocated to the various provinces.

110. When an individual has business income allocated to more than one province, his tax payable to each province is calculated as follows:

$$\begin{array}{c}\text{provincial}\\\text{tax rate}\end{array} \times \text{federal basic tax} \times \frac{\text{business income allocated to province}}{\text{total income}}$$

FEDERAL ABATEMENT FOR PROVINCIAL TAXES

111. The tax collection agreement (and the Ontario Income Tax Act) cannot be fully understood without an appreciation of the federal abatement provisions contained in Section 33 of the Income Tax Act (Canada).

112. As explained earlier in this chapter, in the section dealing with federal-provincial fiscal arrangements, personal income tax room is established for the provinces by the technique of providing an abatement from the federal personal income tax. This abatement reflects the provisions both of Part I of the federal Income Tax and of the Established Programs Act, which relates to various joint programs subject to opting-out arrangements. The tax payable by an individual under Part I of the federal Act is designated the "basic tax". For purposes of the abatement provision, the "basic tax" is the tax ordinarily payable under Part I of the federal Act before the Old Age Security tax has been added and before the following deductions have been made: (1) the abatement for provincial income taxes, (2) the percentage federal tax changes enacted in 1965 and 1966, and (3) the foreign tax credit and the logging tax credit. The provincial tax base therefore does not include Old Age Security tax but on the other hand it is not

reduced by any of the deductions enumerated above. Apart from these specific adjustments, the "basic tax" is the same as the tax calculated in the normal manner under Part I of the federal Act, including the surtax on foreign investment income and the taxes computed on special bases: i.e., lump-sum payments, interest content of blended payments, two fiscal periods ending in one year, farmers' and fishermen's averaging, election in respect of recaptured depreciation, correction of inventory understatements, employees' stock options, sale of inventory, and sale of accounts receivable.

113. The fixed percentages of the federal tax allowed as deductions from the "basic tax" under the present federal Act are 21 per cent for 1965 and 24 per cent for 1966, applicable to all provinces. This rate is increased by 3 percentage points for the residents of any province that provides its own schooling allowance comparable to the federal program under the Youth Allowances Act. For such provinces, the percentages are therefore 24 per cent for 1965 and 27 per cent for 1966.

114. In addition, the federal Established Programs (Interim Arrangements) Act grants additional fixed percentages of federal abatement to residents of any province that opts out of one or more designated federal-provincial shared-cost programs and agrees to administer and finance these programs directly. Any province is free to avail itself of this option. The fixed percentages of abatement for the various programs subject to opting-out are as follows:

Hospital Insurance Program	14%
Old Age Assistance, Blind Persons' Allowances and Disabled Persons' Allowances	2
Unemployment Assistance	2
Technical Training Program	1
Health Grants Program	1
Maximum	20%

115. The federal government has indicated that the maximum percentage abatements for these programs are 20 per cent in the 1965 and 1966 taxation years, 19 per cent for the 1967, 1968 and 1969 taxation years and 14 per cent for the 1970 taxation year.[16] These reducing amounts reflect the fact that the periods covered by abatement for the various programs are not uniform. The Technical Training Program abatement, worth 1 per cent, expires on March 31, 1967, the abatements for Old Age Assistance, Blind and Disabled Persons' Allowances, Unemployment Assistance and the Health Grants Program, worth 5 per cent, expire on March 31, 1970, and the Hospital Insurance Program abatement, worth 14 per cent, expires on December 31, 1970. The federal government has indicated that for 1967 and 1968 it is willing to transfer to the provinces an additional 4 percentage points of personal income tax collections in lieu of certain grants. This raises the abatement to 28 per cent of the "basic tax" for all provinces, to which, of course, the applicable rates of abatement covering the contracting-out arrangements will be added.

[16]Established Programs (Interim Arrangements) Act, S.C. 1964-5, c.54, as amended 1967, c.89, s.24.

116. The rules under which the federal abatement is allowed are uniform with those under which the provincial personal income tax is applied, since both are governed by the allocation rules contained in Part XXVI of the Regulations to the federal Income Tax Act, discussed above. The federal tax is not abated in respect of an individual who has income that is beyond the reach of provincial taxation. Thus income allocated to the Yukon or Northwest Territories, or business income allocated to a foreign country is not eligible for federal abatement, as it is not subject to provincial tax.

117. An individual's abatement is calculated separately for each province to which he pays personal income tax.

118. He is entitled to deduct from the "basic tax" payable by him an amount for each of his provincial personal income tax liabilities calculated as follows:

$$\begin{array}{c}\text{percentage}\\\text{abatement}\\\text{applicable}\\\text{to province}\end{array} \times \begin{array}{c}\text{federal}\\\text{basic}\\\text{tax}\end{array} \times \frac{\text{business income allocated to province}}{\text{total income}}$$

This is essentially the same calculation as is employed in determining income tax liability to each province.

AN EVALUATION OF PRESENT FISCAL ARRANGEMENTS

ALTERNATIVES

119. The fiscal arrangements currently established between the federal government and the Government of Ontario involve, as we have seen, the imposition of personal income taxes under both federal and provincial statutes, with the federal government administering and collecting the taxes for both jurisdictions under a tax collection agreement. There are, as we have seen, other ways in which Ontario might participate in revenue from personal income tax. It could operate under a tax-sharing arrangement, such as the one in effect from April 1, 1957, to March 31, 1962, where the tax was imposed under a federal statute and the Province shared in the yield. Or alternatively, Ontario and the federal government could each impose such taxes under their own statutes, with separate administration and collection.

120. We do not favour the tax-sharing arrangement whereby personal income taxes are imposed under a federal statute and the Province shares in the yield because: (1) the taxpayer is not sufficiently aware of the ultimate destination of his tax dollars; (2) the provinces do not have the responsibility of legislating their own taxes; (3) the agreement does not permit of variations in what may be described as a provincial tax rate; (4) a non-agreeing province is an anomaly when all others are signatory to such an agreement.

121. We would likewise not recommend that Ontario administer and collect personal income taxes imposed under its own statute. Ontario has never collected such taxes, even though personal income taxes have been imposed at various times since 1936. They have been collected under various collection agreements by the

federal government, which has acted as agent of the Province. For the 1964 taxation year almost 2.7 million persons resident in Ontario on the last day of that year filed personal income tax returns with the federal government.[17] Had Ontario administered its own tax that year these would obviously have had to be processed by the Province. In addition, non-resident individuals employed or carrying on business in Ontario and residents of Canada in a province other than Ontario would also have filed provincial returns. The average cost of processing a return by the Taxation Division of the Department of National Revenue for 1966, including individual and corporate income tax and gift tax returns, was approximately \$6.00.[18] The net cost to the Division of collecting \$100 of revenue from these same tax sources during the 1965 filing season was 86¢.[19] There are no figures available that would indicate the average cost of processing a personal income tax return or the cost of collecting \$100 of personal income tax revenue. However, it is safe to assume that the average cost of processing the T1 Short income tax return is lower than the average cost of processing all returns. In 1965 some 5.4 million Canadians filed 1964 T1 Shorts, some 1.3 million filed T1 Generals and some 166,000 companies filed T2 Corporation Income Tax Returns. Some 88,000 estates filed Estate Tax Returns and some 16,000 taxpayers filed Gift Tax Returns.[20]

122. It would be hazardous for us to attempt to estimate the net cost to the Ontario government of collecting personal income tax, but it seems quite clear that with the much more limited resources for cross-checking available to a newly constituted collection department and with the likelihood that recently recruited and trained staff would for some years produce a smaller revenue yield per dollar expended on collection, the net cost per \$100 collected would be significantly higher than that incurred by the federal government. It is true that the Province does administer its own corporations taxes, but the number of returns involved is much smaller. During the 1965 calendar year, approximately 66,000 corporations tax returns were filed in Ontario,[21] and some 166,000 T2 returns were filed throughout Canada[22] with the federal government, of which 58,252 went to Ontario district offices. Additional expense would also be incurred in providing a separate appeals procedure if Ontario administered its own tax. Lacking any current collection machinery and having no past experience in collecting a personal income tax, Ontario would incur, in terms both of money and of effort, a very high cost indeed in administering its own tax. Admittedly, under the present arrangements the Province loses the revenue from penalties, fines and interest collected under the Ontario Act, which the federal government keeps as compensation for its administrative services. For the 1964 taxation year the total for Canada of interest charged

[17]Department of National Revenue, Taxation Division, *1966 Taxation Statistics*, Part I, (for the 1964 taxation year), Ottawa: Queen's Printer, Table I, p. 13.

[18]Figure supplied directly by Department of National Revenue, Taxation Division.

[19]Department of National Revenue, Taxation Division, *Twenty-One Million Dollars a Day*, Ottawa, Queen's Printer 1966, p. 32.

[20]*Twenty-One Million Dollars a Day*, pp. 41-2.

[21]Figure supplied directly by Ontario Treasury Department.

[22]*Twenty-One Million Dollars a Day*, p. 42.

on short instalments and on arrears, and penalties collected for late filing of personal income tax returns amounted to $5.6 million[23]—an average of less than $1 for each taxable return for 1964. Whatever its relationship to the additional costs of collecting the provincial taxes by the federal government, it cannot begin to cover the costs of collecting the personal income tax separately. Furthermore, the additional burdens on taxpayers, both in money and in bother occasioned by the requirement of filing separate returns to two jurisdictions, militate against our advocating such a system. We are not convinced that there are sufficient advantages to be gained from the separate collection of personal income tax to offset the duplication of facilities and staff and the consequent expenses that would be entailed. For similar reasons, we recommend elsewhere in this Report that Ontario enter into an arrangement for the collection of its provincial corporation income tax by the federal government.

EVALUATION OF COLLECTION AGREEMENT

123. We favour the continuation of the present fiscal arrangements for the collection of personal income tax between the two senior levels of government. Our reasons for this conclusion may be summarized as follows:

(1) The tax collection agreement between the federal government and Ontario has worked satisfactorily to date. From time to time there have been errors made in estimating the monthly payments, but these have been quickly corrected and not duplicated. No problems under the agreement were made known to us and we were unable to discover any in our research.

(2) In the agreeing provinces, the collection agreements have ensured uniformity in the determination of taxable income and in its allocation among provinces.

(3) The agreements have enabled the provinces to avoid the very substantial administrative effort and expense of administering their own income tax statutes.

(4) A province retains substantial control over its yield from the personal income tax since it has the right to levy a higher or lower rate than the rate of federal abatement.

(5) Because payments to the provinces are computed by reference to taxes assessed under their Acts, and not on amounts actually paid by taxpayers, the provinces' yields are unaffected by delinquencies in payment.

(6) The problems of taxpayer compliance have been simplified since only one return for both federal and provincial taxes need be filed.

(7) A taxpayer is convenienced by being able to settle both his federal and provincial income tax problems with one administration.

124. Having stated our general agreement with the policy of federal collection

[23]Figure supplied directly by Department of National Revenue, Taxation Division.

of provincial personal income taxes, we should like to discuss what appear to us to be weaknesses in the existing agreement and to recommend specific measures to correct them.

SPECIFIC DEFECTS OF CURRENT COLLECTION AGREEMENT

125. In our view the most significant drawback of the present tax collection agreement is that it deprives a provincial government of the power to determine economic and fiscal policy to the extent these are reflected in legislation governing personal income taxes. Since in 1967 the agreeing provinces' share of the personal income tax yield is 28 per cent, they have a significant stake in the tax base and in the federal rates. Yet under the current agreement the federal government has complete autonomy to "alter or vary" the federal Act and Regulations as it alone sees fit. In addition, if a province should disagree with any aspects of federal tax changes that are intended as instruments of economic policy—for example, a decrease in federal rates to combat a prospective recession at a time when Ontario's prognosis differs from that of the federal government, or when, in its opinion, its need for revenue outweighs the economic considerations—it would still, under the present agreement, be severely limited in its responses.

126. We agree that the income base on which provincial taxes apply should be set by the federal government and that major responsibility for broad stabilization policy rests with that government. But it does not follow that the provinces should be deprived of a significant voice in the determination of the tax base and in stabilization policy, and we are convinced that consultation between the federal and provincial governments should take place prior to the implementation of any proposed income tax amendments. In particular, we believe that unilateral changes by the federal government in the common base of the personal income tax cannot be justified, for they directly affect the yield of the tax to the provinces. *We therefore recommend that:*

> ***Ontario press the federal government to consult the provinces on proposals for changes in the structure of the personal income tax, to ensure the fullest possible measure of agreement.*** 26:1

127. Some of the terms of the 1962-66 agreement give the federal Minister of National Revenue decisive powers where consultation should be provided for. While we recognize that he is responsible for tax administration and collection and therefore must be assured of uniformity as between the federal and provincial Acts, we are convinced that there should be consultation between the provinces and the federal government in respect of the following matters, of which, under the 1962 agreement, the federal Minister is the sole arbiter. That agreement provides:

(1) The Minister may determine the necessity of making, amending or revoking Regulations, forms or tables under the provincial Acts and may require the Provincial Treasurer to implement his determination.

(2) The Minister has power to determine whether the provincial Acts and Regulations give him sufficient authority to collect the taxes and administer uniformly all the federal and provincial statutes. If he is of the opinion that any of them do not meet the requirements of uniformity, he is authorized to specify the changes that he considers necessary. Should a province fail to implement the changes, the Minister may terminate the agreement.

(3) Alternatively, if in his opinion a doubt exists that the Province has provided the requisite statutory or other authority, he is relieved from responsibility for collecting the tax. Any amount of provincial tax that Canada is unable to collect, because in the Minister's opinion there is a lack of sufficient authority to collect it, may be recovered as a debt owed to Canada by the Province.

128. Since these matters are factual ones, it could be argued that they are questions for the courts to decide. But there are also questions of policy involved, and we are of the opinion that these are best resolved by consultation. Once a consensus is reached, the provinces must take the steps necessary to ensure uniformity of administration. If no consensus is reached, the collection agreement would either lapse or be abrogated by one of the parties. *We therefore recommend that:*

Ontario press the federal government for consultation with the provinces in respect of all questions relating to the sufficiency of uniformity between the federal and provincial legislation, and to the adequacy of the authority provided to enable federal collection of provincial tax and administration of provincial legislation. **26:2**

129. At the present time the provinces may impose a personal income tax comparable only to the one imposed under Part I of the federal Act. That Act nevertheless imposes other taxes on individuals, such as a withholding tax on certain remittances from Canada to non-residents and a tax on gifts. In addition, certain taxes are imposed on corporations which are in lieu of taxes on corporate distributions to shareholders. Currently, then, the provinces do not share in the yield from any of these taxes since they are forbidden, under the terms of the agreement, or by the nature of the tax on certain corporate distributions, from imposing them. We are of the opinion that the provinces should share in these revenues. We discuss each of these taxes below.

130. Part III of the federal Act imposes a withholding tax of from 5 to 15 per cent of certain payments, mainly of investment income derived from sources in Canada, that are made to non-residents. These include: (a) management fees; (b) interest; (c) estate and trust income; (d) rents, royalties, etc.; (e) timber royalties; (f) alimony payments; (g) patronage dividends; (h) dividends; and (i) payments for motion picture films and video tape rights. The taxation of such

income has international implications, and the tax treaties entered into by Canada with foreign jurisdictions limit the rate of tax that may be imposed on such remittances. Were the provinces to have access to this tax field, problems would arise. Provinces imposing personal income taxes at rates higher than the federal abatement would have to be limited to a rate equal to the abatement on such remittances if the treaty provisions are to be observed. Similarly, the autonomy of a non-agreeing province might be jeopardized in an attempt to honour treaty obligations. Because of these difficulties, we must conclude that the non-resident withholding tax is not an appropriate field for provincial taxation. We are nevertheless of the opinion that the federal yield from this tax should be shared with the provinces. This could be accomplished if the federal government were to make payments to the provinces (at the rate of the federal abatement of corporation income tax), allocated on the same basis as corporate business income is allocated among the provinces for the year. *We therefore recommend that:*

> ***In the negotiation of any future fiscal arrangements with the federal government, Ontario press for a provincial sharing in the yield from the non-resident withholding tax computed at the same rate as the rate of federal abatement for corporation income tax.*** 26:3

131. The policy aspects and merits of a gift tax are considered in Chapter 28, where we recommend that Ontario levy a gift tax that would be integrated with succession duties. Accordingly, we shall not discuss such a tax here, even though a gift tax is imposed under the federal Income Tax Act.

132. The taxes imposed on corporations in lieu of taxes on corporate distributions to shareholders include:

(a) A 15 per cent tax on undistributed income of a corporation, imposed under Part II of the federal Act.

(b) A tax of either 20 or 30 per cent of the premium payable by a corporation on the redemption or acquisition of its shares other than common shares, imposed under Part IIA of the federal Act.

(c) A tax of either 15 or 20 per cent payable by a corporation on the amount of a dividend paid out of its "designated surplus" when it was controlled by a non-resident person, an exempt person other than a personal corporation, or a trader or dealer in securities, imposed under Part IIB of the federal Act.

(d) A tax of 20 per cent payable, upon the amalgamation of two or more corporations, on the amount by which the combined undistributed income of the amalgamated corporation exceeds the value of its net assets excluding goodwill, imposed under Part IIC of the federal Act.

133. Because the imposition of these taxes on corporations has the effect of relieving the shareholders of personal tax on amounts then or later received by

them, Ontario loses revenue which it might otherwise have obtained from the personal or corporate income tax. Under the present tax structure, any sharing in their yields by the provinces would have to be effected by intergovernmental payments. We think that as the predominant effect on provincial revenues caused by these taxes is a reduction on the yield from personal income tax, the Province should share in the special taxes in the same proportion as the abatement of the federal personal income tax. There are various methods by which the provinces' share of the yields could be allocated among them.

(a) The allocation could be made to the province of residence of the shareholders, in proportion to their holdings in the corporation paying the special tax or taxes; or

(b) the allocation could be directly proportionate to the abatements of federal personal income tax in respect of income taxes imposed by the provinces; or

(c) the provincial share of the tax paid by each company paying a special tax could be apportioned on the same basis as its income for the year is allocated among the provinces.

Of these three possibilities we prefer the last, because compared to the second method it would come much closer to recognizing the proportions in which the income tax revenues of the provinces would have been increased, if the distributions had been subject to ordinary rates of tax, and because the first method is administratively infeasible. *We therefore recommend that:*

In the negotiation of any future fiscal arrangements with the federal government, Ontario press for provincial sharing in the yield from the taxes imposed upon corporations in lieu of taxes on corporate distributions to shareholders, such provincial sharing to be in the same proportion as the personal income tax abatement and to be allocated among the provinces in the same proportion as the income of each corporation liable for such a tax is allocated for purposes of corporation income tax abatement. **26:4**

134. The rules in the agreement requiring that a province advise the federal government by October 1 of any year of its intention to change its rate as of the following January 1 create practical difficulties. Since the Ontario Legislature usually sits in the spring, the rules respecting rate changes would require a legislative amendment at that time to impose a new rate of tax, which then could not go into effect until the following January 1. In addition, the right of the Province to increase its rate to offset a reduction in federal taxes is subject to specific rules. It is possible (but not likely) that the Ontario Legislature could have prorogued before the federal budget is presented. Should it have done so, a special session would then need to be called in the fall before the October 1 deadline, to take corrective action if federal changes disturbed the Ontario budget.

135. Cognizant of the effects of federal tax changes on provincial revenues, the federal government in both 1965 and 1966 made changes in its rate structure in such a way as not to affect the provincial tax base. Similarly, the December 19, 1966, Supplementary Budget Address announced changes in the federal Old Age Security tax, but again not affecting the provincial tax base. We are aware that this method is not an unmixed blessing for the provinces—it prevents the provincial base from shrinking when federal taxes are reduced, but it could also be used to prevent the base from increasing when taxes are raised. None the less, we conclude that it has offered a very practical solution to one of the problems we pose and we hope that it will continue to be used with any future reductions in federal tax.

136. We are of the opinion that it should be possible for Canada and the provinces to work out a more practical timing for provincial rate changes to ensure that a province is able to alter its fiscal policies to reflect changing conditions. *We therefore recommend that:*

> ***Ontario press for amendments in the provisions of the tax collection agreement that would permit it to notify the federal government of its intention to change its rate of taxation for a year at a date later than October 1 of the preceding year, the date now required.*** **26:5**

EVALUATION OF INCOME ALLOCATION RULES

137. Over the years since income taxes have become a permanent and universal feature of the world scene, patterns for coping with international tax problems have developed, which have as one of their prime purposes the avoidance of double taxation of the same income by two jurisdictions, both of which may have a right to tax the income or the person under their national laws. These patterns have become increasingly standardized in the many international tax treaties and conventions that govern the taxation of income derived from international business activities as well as that of persons who perform personal services in other than their country of residence. In broad terms, it may be stated that under the international treaties, one contracting country agrees to tax only the industrial or commercial profits of a business enterprise of the other contracting country if the business has a "permanent establishment" in its territory. An individual who performs personal services in other than his country of residence is subject to tax in the foreign country on the employment income that he earns there. This rule is modified where the employment is transient or casual: special rules under the treaty usually then limit the taxing right of the country in which the employment is performed. The country of residence taxes the world income of its residents and grants a foreign tax credit for income that has been taxed in another jurisdiction under the international rules. It is against this international pattern that we propose to examine the allocation rules governing provincial income tax liability. In doing so we are not suggesting or arguing that the situations are strictly comparable, but only that we may perhaps derive inferences that might improve the present provincial allocation rules.

138. The rule that allocates all of a person's income from all sources, other than his extra-provincial business income, to his province of residence on the last day of the taxation year results in certainty for the taxpayer. But it also produces some distortion of provincial revenues, since many people move from one province to another during the course of the year, while others earn employment income in provinces in which they do not reside. For the years 1956-1961, the last years for which data are available, the provinces of British Columbia, Alberta and Ontario were the only ones to show a net gain in interprovincial movements of persons five years of age or over, the net gains being respectively 33,230, 16,787 and 34,274 persons during this five-year period. All of the other provinces were net losers of population, ranging from 33,577 persons for Saskatchewan to 1,099 for Prince Edward Island.[24]

139. Of a total interprovincial migration of 526,790 persons,[25] 232,560 or 44.15 per cent were in the labour force.[26] All of these figures are based on a household sample which excludes collective-type residences such as institutions, hotels and large lodging-houses. Temporary residents are also excluded. The population figures therefore need upward revision to reflect more accurately the actual numbers of migrants and their number in the labour force. To arrive at a figure that would reflect potential taxpayers, it would be necessary, then, to adjust the net interprovincial mobility figures quoted above. The patterns of interprovincial migration during the following five-year period, 1962-1966 inclusive, remained the same, but the actual number of migrants showed considerable variation.[27] It is fairly safe to assume that as a result of the allocation rules British Columbia, Alberta and Ontario would have shown net gains and all the other provinces net losses, but just how much is problematical. Since the annual net gain or loss of potential taxpayers in any one province is relatively small in proportion to total population, we conclude that provincial revenues were substantially unaffected by this method of allocation. Furthermore, by not requiring a taxpayer to make allocations of his employment income to several provinces, administration is simplified and the burden on the taxpayer is eased.

140. Different considerations might apply to persons who reside in one province but work in another. This is of some significance for Ontario and Quebec because all along both sides of the Ottawa River there are communities whose residents work on the other side. It is particularly significant in the Ottawa-Hull metropolitan area, where on September 30, 1964, the federal government alone employed 48,190 persons, some 23.7 per cent of the total number of its employees, and paid them, during September 1964, some $21.5 million in salaries.[28] There

[24]Dominion Bureau of Statistics, *Canada Year Book, 1966*, pp. 185-7.

[25]Dominion Bureau of Statistics, *Census of Canada, 1961*, "General Characteristics of Migrant and Non-Migrant Population", Ottawa: Queen's Printer, Bulletin No. 4. 1-9, Table 11.

[26]*Census of Canada*, "Migrant and Non-Migrant Population in the Labour Force", Bulletin No. 4. 1-10, Table J1.

[27]Information supplied directly by Dominion Bureau of Statistics.

[28]Dominion Bureau of Statistics, *Canada Year Book, 1966*, p. 149.

are no data available to indicate how many residents of Quebec were employed in the five Ontario municipalities or how many residents of Ontario were employed in the eight Quebec municipalities comprising the Ottawa-Hull metropolitan area, but the numbers are substantial.

141. Taxpayers who derive income from an office or employment are subject to withholding of tax from their salaries or wages. Section 102 of the Income Tax Regulations and the Notice to Employers accompanying the Tax Deduction Tables instruct employers to deduct tax payments from employees according to the table established for the province in which they report for work. Where an employee is not required to report for work at any establishment, his deductions will be based on the table in force at the office from which he is paid, in accordance with Section 100(4) of the federal Income Tax Regulations. But since an employee's liability for provincial tax depends on his residence, the tax to be deducted under these rules may vary substantially from his actual tax liability. To meet this situation, the federal government has in practice granted employers the option of treating a taxpayer's place of residence as being the place to which he reports for work, subject to the employee's concurrence, so long as adequate tax is deducted to cover the employee's liability. Alternatively, the employee may follow the Regulations.[29]

142. In order to ensure the workability of the tax deduction system for persons residing in a province other than the one in which they work and for those who have moved during the year, the provincial Acts provide that if both provinces have signed collection agreements, the province of residence will give credit for the tax deductions in the other province, and the other province will not make any refund of the deductions. The province of residence provides any refund if the total tax deductions made in both provinces exceed the taxpayer's provincial tax liability for the year. Among agreeing provinces, the accounting problem is resolved by the federal government on behalf of the provinces. Since Quebec collects its own taxes, the Ontario Act gives the federal Minister of National Revenue authority to make adjusting payments to Quebec on behalf of Ontario for tax collected in Ontario that under the allocation rules belongs to Quebec. This provision is conditional upon Quebec's making similar adjusting payments to Ontario for tax allocable to it. Again, the taxpayer may not obtain a refund from Quebec of tax deductions made in Quebec if he resides in Ontario on the last day of the taxation year, nor may he obtain a refund from Ontario of tax deductions made in Ontario if he resides in Quebec on that day. The taxpayer in each case must look to the province in which he resided on December 31 for his relief.

143. The pay-as-you-go system of withholding tax from salaries and wages is particularly suited to an allocation rule that ascribes a preferential right to tax to the jurisdiction in which the income is earned. The residence rule, as we have seen, gives rise to problems which the federal government practice has resolved, although Section 47 of the federal Act provides for withholding of tax from salaries and wages in accordance with the prescribed rules.

[29] *Ontario Tax Reporter*, Toronto: CCH Canadian Limited, paragraph 18-360.

144. Having dwelt at considerable length on the problems arising out of the residence rule we are constrained to the view that it is none the less justified and should be continued. In our view its convenience to taxpayers, and no doubt to the federal government in its data processing of income tax returns, outweighs the theoretical and practical problems that we have raised.

145. As we have already stated, an integral aspect of international taxation is that the country of residence taxes its residents on their world income and grants a tax credit for income that has been taxed in another jurisdiction under the international allocation rules. Under the provincial allocation rules, however, a province's right to tax its residents is limited. Business income that is allocated to another province or territory of Canada or to a foreign country is beyond the purview of the province of residence. If all provincial rates were uniform, and if all provinces set a rate as a percentage of the basic federal tax, this restriction on the taxation of business income would be of no consequence; the end result of taxing a resident on his world income, including business income from another jurisdiction, and of granting an interprovincial tax credit for taxes paid to that jurisdiction on the business income earned there, would be the same as is achieved through the tax allocation method now used by the federal government for collecting provincial taxes. But where provincial rates vary or other differences occur, anomalies arise. For example, both Manitoba and Saskatchewan have set a rate based on the federal tax payable that is higher than that in the other agreeing provinces, while Quebec imposes a separate set of graduated tax rates on taxable income. Under the present allocation rules, a business proprietor residing in Manitoba or Saskatchewan and doing business both in his province of residence and, say, Ontario pays less tax than if all of his income had been earned in his province of residence. To illustrate, if all of his income had been earned in the province of residence, he would be liable at 1967 rates for provincial tax of 33 per cent of all of the basic federal tax on his total income. If one-half of his income were income from a business in Ontario, he would be liable for Manitoba or Saskatchewan tax of 33 per cent of one-half of the basic federal tax and for Ontario tax of 28 per cent of one-half of the basic federal tax. He thus would pay altogether 5 per cent of one-half of the basic federal tax *less* than the tax that would have been payable if all of his income had been earned in Manitoba or Saskatchewan. On the other hand, if the circumstances had been reversed and the taxpayer were resident in Ontario with one-half of his income earned from a business in Manitoba or Saskatchewan, he would pay altogether 5 per cent of one-half of the basic federal tax *more* than the tax of 28 per cent on the full basic federal tax that would have been payable if all of his income had been earned in Ontario.

146. Under a system in which a province taxes all of the income of its residents earned in any province of Canada and allows an interprovincial credit of the lesser of the tax actually paid to another province on the income earned there, or the tax that would have been payable on this amount of income had it been earned in the

province of residence, a Manitoba (or Saskatchewan) resident would pay a full 33 per cent of the basic federal tax in provincial taxes. The Ontario tax would be 28 per cent of one-half of the basic federal tax and the Manitoba tax would be 33 per cent of the basic federal tax less the tax payable to Ontario. If the taxpayer had been resident in Ontario with one-half of his income from a business in Manitoba, he would pay 33 per cent of one-half of the basic federal tax to Manitoba, and his Ontario tax would be 28 per cent of the full basic federal tax less a credit for Manitoba tax of 28 per cent (since Ontario's rate of 28 per cent is less than Manitoba's rate of 33 per cent) of one-half of the basic federal tax.

147. The adoption of a system of interprovincial tax credits in substitution for the present tax allocation system would not now result in any gain in revenue for Ontario in respect of income earned from business carried on by its residents in provinces other than Quebec. This is because Ontario's rate of tax does not exceed the rate imposed by these provinces. However, because Quebec has chosen to adopt a system of personal income tax that imposes graduated rates of tax on income earned by non-residents from businesses carried on in Quebec in excess of personal exemptions and other deductions, the effective rate of tax imposed in Quebec on such income is often substantially less than the effective rate of Ontario tax, and where such income is less than the amount of exemptions and deductions allowed in Quebec, no tax is imposed by Quebec.

148. A married man residing in Ontario with two dependent children over 16 years of age and a taxable income of $10,000 including income of $3,200 from a business carried on in Quebec is at present not liable for any Quebec tax. If the business had been in Ontario he would have been subject at 1967 rates to Ontario tax of $148.30 on the income of $3,200 from this source; i.e., 28% of $\frac{3{,}200 \text{ (business income)}}{13{,}200 \text{ (net income for the year)}}$ of the federal basic tax of $2,170 on a taxable income of $10,000.[30] Because the income was earned from a Quebec business, the taxpayer would be allowed an abatement of his federal tax of $263.03; i.e., 50 per cent of $\frac{3{,}200}{13{,}200}$ of the federal tax of $2,170. It is remarkable that:

(a) the taxpayer gets a reduction of $263.03 from his federal tax for Quebec tax that he doesn't have to pay, but

(b) if the Quebec business income had been taxable in Ontario he would have paid $148.30 additional Ontario tax.

If a system of interprovincial tax credits were established in place of the present tax allocation system, the taxpayer in our illustration would have paid $148.30 additional tax to Ontario since he would have had no liability for Quebec tax and hence no deduction from Ontario tax for Quebec tax. However, he would still receive the benefit of federal abatements that exceeded his provincial taxes by $114.73 unless the federal government changed its method of making abatements.

[30]These calculations are based on the rates and abatements applicable to 1967 as of April 1967.

149. It is clear, therefore, that under present circumstances Ontario would gain from substituting a system of interprovincial tax credits for the present tax allocation scheme in respect of taxes on business income earned by Ontario residents in Quebec. Ontario would also gain with respect to taxes on such income earned in a province other than Quebec if at any time the Ontario rate of tax were increased beyond the rate imposed by that province. This therefore poses the question: should Ontario press for a system of interprovincial tax credits? For the reasons given below, our answer to this question is: not at this time.

150. First, such a system would introduce additional complications into the provincial personal income tax structures without having any important effect on the yield. The amount of business income earned by individuals in provinces other than the province of residence is not significant, and so, while some taxpayers do benefit unduly, the over-all effect on the revenue is not significant. Taxpayers carrying on business in partnerships that extend over several provinces, such as public accounting practices, are most likely to be affected.

151. Second, such a system would in effect garner for Ontario the tax that another province failed to collect. This being so, Quebec, for example, should take such steps as are necessary to impose a tax on business income of non-residents at least equal to the amount of abatement of federal tax that such taxpayers enjoy in respect of their business income earned in Quebec. While it is tempting for Ontario to pick up the tax that other provinces fail to collect, it would be more appropriate if the other provinces were to collect the tax.

152. Third, so long as Ontario's personal tax is collected by the federal government, such a system could not be introduced by Ontario unless all other provinces with collection agreements with the federal government were to agree to a similar change. Most of the other provinces, except perhaps Manitoba and Saskatchewan, would gain very little from such a change, and would therefore not likely be interested.

153. While we do not suggest that Ontario press for a change to the tax credit system now, our views would change if Ontario's rate of personal tax ever became significantly higher than in other provinces. This is because we do not think that it would be equitable if Ontario residents without any extra-provincial income were required to pay to Ontario higher taxes than those that have such income would pay on the same total incomes to Ontario and one or more other provinces.

RATE OF TAX

154. During the period of the 1962-66 agreement, Ontario has been able to impose its tax rate in an amount equal to the federal abatement under the Income Tax Act, with the result that no Ontario taxpayer has borne provincial tax in excess of the abatement. While we may hope that this happy state will endure as long as

any system of tax sharing, we would be remiss if we did not consider the extent to which the personal income tax rate could be raised above the federal abatement without giving rise to adverse economic effects, in the event that the Province's need for additional revenues forces it to contemplate a personal tax rate in excess of the abatement. In Chapter 6 we have made our own projections of the expenditure, revenue and debt of the local and provincial governments of Ontario for the years 1966 to 1975. Also available are the projections of government revenues and expenditures for the years 1967-1972, as prepared by the Tax Structure Committee and submitted to the Federal-Provincial Conference in October 1966.[31] Both series of forecasts indicate that the financial position of the provincial-municipal governments will worsen and that of the federal government will improve. Within the next five years, provincial-municipal expenditures in Canada are expected to climb to between $16 and $16.25 billion, an annual rate of increase from 1966-67 of about 8.5 per cent. Federal government expenditures will rise to about $12.75 to $13 billion, an annual rate of increase of about 6.5 per cent. Provincial-municipal revenues, on the other hand, are projected at between $13.5 and $14 billion, and those of the federal government, between $13 and $13.75 billion. Provincial-municipal deficits will increase from the present $900 million to some $2.4 or $2.1 billion, depending on whether G.N.P. grows at 6 per cent or 7 per cent. The federal government's present position of near balance will become one of a surplus of some $325 or $725 million, again depending on the rate of growth of G.N.P. Editorializing on the government news release concerning the projections of the Tax Structure Committee, the Canadian Tax Foundation[32] pointed out that the projected revenue figures for all levels of government are not large enough to cover their expenditure expectations over the next five years. Even if the potential federal surplus were made available to the provinces by way of increased abatement, the projected combined provincial-municipal deficits would be reduced by at most one-third, and additional revenue would have to be found to fill the gap. In the light of these projections it is apparent that provincial taxes will have to be increased. The questions to be answered are which ones and by how much.

155. If the federal government could be prevailed upon to make available to the provinces by way of an increased personal income tax abatement that amount of tax room sufficient to obviate the need for any other tax rise, the problem would

[31]Department of Finance, News Release, October 28, 1966. The assumptions on which the Tax Structure Committee's projections are based include: (1) G.N.P. will grow at 6 per cent or 7 per cent per annum; (2) the cost to governments of goods and services will rise consistent with G.N.P. assumptions; (3) the population of Canada will grow as projected by the Economic Council of Canada; (4) government revenues will rise at rates consistent with the population, production and income assumptions; (5) revenue figures are based on tax rates in effect in 1966; and (6) the expenditures are based on projections of the estimated costs of certain defined programs including all extant programs and Medicare, but excluding expenditures for the guaranteed income plan, the new proposals for the years 1967 and 1968 in regard to equalization, and fiscal transfers relating to education.

[32]"Fact and Opinion", *Canadian Tax Journal*, Vol. XIV, 1966, No. 6, p. 483.

be solved. Since, on the basis of the projections, this seems most unlikely, Ontario's personal income tax rate may have to be increased to a level higher than that provided by the abatement. Just how much higher is a moot point. As pointed out in our economic analysis earlier in this chapter, there is no clear theoretical evidence of the dis-incentive effects of a personal income tax. In addition, the experience of the provinces of Manitoba and Saskatchewan provides no pragmatic evidence of deleterious effects on incentive. Both of those provinces impose personal income tax rates that are 5 percentage points higher than the federal abatement and corporate income tax rates 1 percentage point above the abatement.[33] Nor is there any such evidence in Ontario and Quebec, which impose corporate income tax rates 2 percentage points higher than the abatement. It is instructive to note that the surtax in both Manitoba and Saskatchewan had initially been set at 6 percentage points above the abatement. Manitoba reduced its surtax in 1965 to 5 percentage points, and Saskatchewan followed suit in 1966. Both provinces are maintaining their additional taxes at the level of 5 percentage points for 1967. Quebec and Ontario have imposed their higher corporate income tax rates for many years.

156. It is certainly true that the level of personal tax rates in effect in other provinces and in the United States will tend to act as a brake, if not an absolute ceiling, on the rate that Ontario may seek to impose. While tax-haven jurisdictions are becoming increasingly rare, any sizeable variation among provincial rates might produce the phenomenon of a tax-haven province for the most mobile of our populace, or at any rate for those who derive their main income from investments. Salary earners and business entrepreneurs are less mobile, being influenced respectively by job opportunities, and the availability of markets and supplies of the factors of production. Furthermore, if a government were to enact provisions relieving certain taxpayers from the strict incidence of its tax in certain circumstances in order to prevent confiscatory taxation as, for example, in the present corporate distribution provisions, it would thereby provide other taxpayers with a rationalization for their own tax minimization measures. In any event, since the provincial taxes are a percentage of the federal rate structure, any fundamental rate reforms under the present arrangements will have to be made at the federal level.

PROVISIONS OF THE INCOME TAX ACT, 1961-62

157. The Ontario Income Tax Act, 1961-62, was enacted during the 1961-62 session of the Ontario Legislature, and has been amended annually since that time. An earlier statute had been passed in 1960-61, but was not proclaimed and was superseded by the later Act.

158. The Ontario Act reflects the terms agreed upon in the 1962-66 collection

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[33]In 1966, Manitoba and Saskatchewan imposed personal income taxes of 29 per cent of the federal tax payable when the abatement was 24 per cent; they imposed corporate income taxes of 10 per cent of taxable income when the federal abatement was 9 per cent.

agreement. It imposes a personal income tax on persons resident in Ontario on the last day of the taxation year or on persons who had income allocated in Ontario in the year at the rate of 16 per cent in 1962, 17 per cent in 1963, 18 per cent in 1964, 21 per cent in 1965, and 24 per cent in 1966. A 1966 amendment applicable to 1967 imposes a tax of 28 per cent of the federal tax payable in respect of the 1967 taxation year. These rates are equal to the rate of federal abatement for each of the taxation years 1962 to 1966 inclusive, and the 1967 rate is the same as the abatement proposed for 1967 at the interprovincial conferences held in the fall of 1966. The federal allocation rules discussed above are incorporated by reference. Because the Ontario tax is calculated as a percentage of the tax payable under the federal Act, the Ontario Act does not contain any provisions for the determination of income or taxable income. It does, however, contain detailed provisions pertaining to administration, which are either identical to, or substantially the same as, the comparable provisions under the federal Act. A number of provisions of the Act that in our view are defective are commented upon below.

LOGGING TAX DEDUCTION

159. Under the provisions governing federal abatement for provincial income taxes contained in Section 33 (3) (c) of the federal Act, the federal tax payable for purposes of the abatement is not reduced by the logging tax credit. For purposes of Ontario tax liability, however, Section 3(4) (a) of the Ontario Act provides that the federal tax payable is reduced by the federal logging tax credit, with the result that an individual who is subject to Ontario logging tax would pay less income tax under the Ontario Act than the amount of his abatement under the federal Act. There is no indication to this effect on the T1 General form or in the T1 General Guide—something that should be corrected without a recommendation from us.

160. When the federal government introduced the logging tax credit of two-thirds of the logging tax payable to a province in 1962, it invited those provinces imposing a logging tax to grant a tax credit of one-third of the logging tax payable from their income taxes, and thereby effectively abolish the additional taxes on income derived from logging operations. The contemplated change would have transferred to the provinces two-thirds of the revenue yields from their logging taxes without imposing any additional taxes on income derived from logging operations. Ontario provided for a tax credit of one-third of the logging tax paid by corporations to Ontario under its Corporations Tax Act, but made no similar provision for logging taxes paid by individuals. The method of computation described above only partially offsets this discriminatory practice against individuals.

161. The example appearing below shows a calculation of the federal and Ontario income taxes payable by an individual who is subject to provincial logging tax. This example illustrates the reduction in federal and Ontario income taxes resulting from the logging tax liability and also shows the amount of logging tax for which no credit is obtained in computing income taxes.

EXAMPLE

Assume that in 1967 an individual had income of $22,000 all of which was from logging operations in Ontario and that his taxable income for the year was $19,000. His tax liability (at the rates in force in April 1967) and the effect upon him of the logging tax would be calculated as follows:

Computation of total taxes payable		
Ontario logging tax (10% of income from logging operations in excess of $10,000)		$1,200
Federal income tax (excluding Old Age Security tax) before deductions in respect of provincial income tax and logging tax but after deduction of $20 maximum reduction		$5,850
Abatement for provincial income tax—28% of $5,870	$1,644	
Deduction for provincial logging tax—2/3 of $1,200	800	2,444
Net federal tax		3,406
Add Old Age Security tax		240
Federal tax payable		3,646
Ontario income tax—28% of $5,070 ($5,870—$800)		1,420
Ontario logging tax		1,200
Total taxes payable		$6,266
Reduction in Ontario income tax for logging tax		
Abatement of federal tax for provincial tax		$1,644
Ontario income tax as above		1,420
Reduction in Ontario income tax by reason of logging tax credit in calculation of federal tax		$ 224
Ontario logging tax not recovered from income taxes		
Ontario logging tax		$1,200
Logging tax credit under federal Act	$ 800	
Reduction in Ontario tax shown above	224	
Total reduction in federal and Ontario income taxes by reason of logging tax liability		1,024
Ontario logging tax for which no income tax credit is obtained		$ 176

162. We are recommending in Chapter 33 on revenue from forest resources that Ontario negotiate with the federal government the repeal of the logging tax, in return for an additional share of income taxes imposed on taxpayers engaged in logging that approximates the present net return to Ontario from the existing logging tax arrangements. This would, of course, eliminate the problem. Until such time as these changes might be implemented, the adoption of a provision in the Ontario Income Tax Act granting a tax credit to an individual of one-third of his logging tax payable would permit him to obtain full credit for his logging tax liability under a combination of the logging tax credit provisions of the federal and Ontario Acts. At the same time, it would be desirable to make the calculation of income tax payable under the Ontario Act identical with the calculation of the abatement under the federal Act. *We therefore recommend that:*

Section 3 (4) (a) of The Income Tax Act of Ontario be amended 26:6

(a) to provide that the "tax payable under the Federal Act" for purposes of calculating the Ontario income tax be the amount as defined at present plus the amount of any credit for provincial logging tax deducted under Section 41A of the federal Act, and

(b) to permit an individual to deduct from his Ontario income tax an amount equal to one-third of the tax payable by him under The Logging Tax Act.

FOREIGN TAX CREDIT

163. The foreign tax credit allowed under Section 41 of the federal Act is limited to a proportion of the federal tax payable after deducting the tax abatement in respect of provincial income tax. By reason of this limitation, the tax imposed by a foreign country on an individual's income earned in that country may exceed the amount of the foreign tax which is deductible from the tax payable under the federal Act. Accordingly, it is provided in Section 3(6) of the Ontario Act that an individual residing in Ontario on the last day of a taxation year and having income from a foreign country for that year may be entitled to deduct all or part of this excess from the tax otherwise payable under the Ontario Act.

164. It is indicated in paragraph 39 of the 1966 T1 General Guide that where the federal foreign tax credit is less than the tax paid to a foreign country, the taxpayer (unless he resides in Quebec or British Columbia) is entitled to a further credit against provincial income tax. Form T2036 has been prescribed by the Minister of National Revenue for calculating the amount of the provincial income tax where a foreign tax credit is deductible in computing that tax. The tax credit allowed under Section 3(6) of the Ontario Act is determined by reference to income *earned* in a country other than Canada, whereas the tax credit allowed under Section 41 of the federal Act refers to income *from sources* in a foreign country. On a technical interpretation of the Ontario Act, a tax credit might not be claimed in respect of foreign investment income since it is not "earned". However, there is nothing in form T2036 to distinguish between income earned in a foreign country and income from sources in such a country. *We therefore recommend that:*

The tax credit for foreign tax under The Income Tax Act of Ontario be determined by reference to income "from sources in" a country other than Canada, rather than income "earned in" such a country. 26:7

165. The amount deductible as a foreign tax credit under Section 3(6) of the Ontario Act, in respect of the portion of foreign tax that is not recovered from the federal tax, is limited to that proportion of the federal tax abatement for provincial taxes that the taxpayer's income earned in the foreign country is of his entire

income. This results in an unduly large deduction under the Ontario Act where part of the taxpayer's income is attributable to a permanent establishment in Quebec. This is because of the much higher rate of federal abatement that applies to the Quebec income. On the other hand, the amount deductible would be unduly limited in the event that Ontario should increase its rate of income tax above the rate of federal tax abatement. The maximum foreign tax credit deductible under the Ontario Act should be limited to a proportion of the income tax payable under the Ontario Act, rather than to a proportion of the abatement for personal tax under the federal Act. *We therefore recommend that:*

> ***The amount to which the tax credit for foreign tax is limited under paragraph (b) of Section 3(6) of the Act be a proportion of the tax payable under the Act, rather than a proportion of the abatement for provincial tax under the federal Act.*** **26:8**

AVERAGING PROVISIONS FOR FARMERS AND FISHERMEN

166. A 1964 amendment to the Act provides special rules for computing the tax of a farmer or fisherman who files an election under the federal Act to average his income over a five-year period.

167. An individual whose principal source of income is farming or fishing may not elect to calculate his Ontario tax on an averaging method under Section 4a of the Ontario Act unless throughout the averaging period he either

(a) resided in Ontario and did not carry on a business having a permanent establishment outside Ontario, or

(b) resided outside Ontario and had no income other than business income attributable to a permanent establishment engaged in farming or fishing in Ontario.

If he has not complied with either of these conditions throughout the entire averaging period, he will be subject to Ontario tax determined by reference to the tax which would have been payable under the federal Act if no election to average had been made.

168. The administrative burden is considerably eased by the provisions outlined in the preceding paragraph. These are nevertheless very stringent and may deprive some taxpayers of the right to average income from farming or fishing for provincial income tax purposes. Furthermore, since this averaging provision is applicable to income from farming or fishing in Ontario only, any income derived from farming outside Ontario may not be included in the averaging. *We therefore recommend that:*

> ***A taxpayer who has elected to average his income under the federal Income Tax Act be similarly treated under The Income Tax Act of Ontario even if he resided in another province or earned business income outside Ontario during*** **26:9**

> ***the averaging period; but the saving in Ontario tax resulting from the election to average be limited to the proportion of the amount otherwise applicable that his income attributable to Ontario is of his total income for the five-year period.***

ASSESSMENTS

169. Section 8 of the Ontario Act, which provides for the making of assessments, is in substance identical with Section 46 of the federal Act. It is provided in Section 8(5) that where a collection agreement is entered into, the Minister of National Revenue shall reassess or make additional assessments where the tax payable under Part I of the federal Act is reassessed even though more than four years have elapsed after the date of the original Ontario assessment.

170. In the event that the amount of the federal tax is changed either by a decision of the Minister following a notice of objection or by the Tax Appeal Board or a Court, this will automatically change the amount of tax payable under the Ontario Act. In these circumstances the Ontario tax is normally reassessed to give effect to the change in the amount of the federal tax payable. However, there is no provision in the Ontario Act requiring that this be done. *We therefore recommend that:*

> ***Provision be made in The Income Tax Act of Ontario requiring that a reassessment be made if the amount of federal tax for any year is changed by a decision of the Minister following the filing of a notice of objection, or by a decision of the Tax Appeal Board or a Court.*** 26:10

APPEALS

171. Sections 19 to 24 inclusive of the Ontario Act provide for appeals to the Supreme Court of Ontario. It is provided in Section 19(2) that such an appeal may be taken only with respect to one or more of the following questions:

(a) The taxpayer's residence for the purpose of the Act;

(b) the taxpayer's income allocated in the taxation year to Ontario; or

(c) the amount of tax payable under the Ontario Act based on the amount of tax payable under the federal Act.

It is specifically provided that no appeal may be taken in respect of the computation of the amount of tax payable under the federal Act, "in order to prevent the tax base itself from becoming subject to independent determination by different tribunals".[34]

172. The fee for lodging an appeal in the Supreme Court of Ontario is $400 or such lesser amount as the Treasurer requires. The problems associated with appeals under this Act are discussed in Chapter 25 on provincial revenue legislation: administration and appeals, and are therefore not discussed here.

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[34] D. H. Sheppard, "Federal-Provincial Tax Collection Arrangements", *Canadian Tax Journal*, Vol. X, No. 1, 1962, Toronto: Canadian Tax Foundation, p. 8.

CALCULATION OF INCOME TAX AND T1 RETURNS

173. The T1 General and the T1 Short income tax returns, prescribed by the Minister of National Revenue, have been designed to enable taxpayers to report their joint federal and provincial income tax liability. They provide for a determination of the federal "basic tax", a deduction of the federal abatement in respect of provincial tax, and an addition of the provincial personal income tax payable. This computation is complicated: during the 1965 filing season some 15 per cent of all personal income tax returns that were filed contained errors.[35] The forms are designed to make taxpayers aware of the respective amounts of federal and provincial tax they are paying. The method of calculation is such that the same forms can be used throughout Canada. Residents of Quebec do not include any provincial personal income tax in their calculations, while residents of Manitoba and Saskatchewan calculate their provincial income tax at a rate 5 percentage points higher than the rate in the other provinces.

174. While it would be possible to devise a simpler form in which the proportion of the total tax payable to a province could be explained on the form for the information of a taxpayer without requiring him to make a separate computation of the provincial tax, we do not favour such a procedure. A separate calculation of provincial personal income tax impresses on a taxpayer that his personal income tax payments cover both federal and provincial tax liability. In fact, we favour indication of this fact in the heading of the T1 Short and T1 General forms themselves.

GENERAL CONSIDERATIONS RELATING TO THE PERSONAL INCOME TAX

175. As we stated earlier in this chapter, we favour the continuation of federal collection of Ontario's personal income tax, as a percentage of the federal tax payable, but subject to federal-provincial consultation regarding any proposed changes in the structure of the federal Act. In this latter connection, we think it useful to advance some general propositions as these relate to the whole structure of federal and provincial personal income taxes. We wish to make it clear, however, that we did not commission any studies on the structure of federal income tax, as this was the subject of a thorough examination by the federal Royal Commission on Taxation and we did not wish to duplicate these studies in view of our other responsibilities. Nevertheless, we have developed general views on personal income tax that we are prepared to express.

176. The federal Act contains no definition of income. Rather, it states in Section 3 that a taxpayer's income is his income from all sources including businesses, property, and offices and employments. Section 6 lists certain receipts that are to be included in computing income, and Sections 5 and 10 itemize certain receipts that are not to be included in computing income. These provisions do not

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[35] *Twenty-One Million Dollars a Day*, p. 14.

in themselves resolve all legal problems because accretions to capital are not subject to tax under the present federal Act and it has been left to the courts to delineate the scope of the statute by determining whether a particular receipt is of an income or capital nature. In an agricultural economy, or one in which income is derived primarily from the rental of land, the problems of separating the fruit from the tree, or the return from the asset, are relatively simple. In an industrial society the problems are much more complicated. The question of whether a receipt is income or a "capital gain" has been the most perplexing tax question presented for adjudication to the tax courts over the years and continues to be such. While each case must be decided on its own facts, decisions of the courts often appear to conflict with one another, a circumstance that casts considerable doubt on the efficacy of the criteria developed by the courts to distinguish a "capital gain" from income. Deferring for the time being consideration of the taxation of capital gains, we address ourselves to certain deficiencies that we see in the present income tax base.

177. For both pragmatic and theoretical reasons we favour the elimination of many of the income exemptions and exclusions now contained in Sections 5 and 10 of the federal Act. For example, we think that such receipts as the following should be included in income: service and R.C.M.P. pensions, compensation received under workmen's compensation legislation of Canada or a province, unemployment insurance, and expense allowances received by members of the House of Commons or Senate of Canada, elected members of a provincial legislative assembly and elected officers of a municipal corporation. We also disagree with the allowance provided under Section 11 of the Act for the rental paid by or the value of a residence occupied by a clergyman.

178. On the other hand, we believe that the Act should allow persons receiving salaries, wages or other remuneration to deduct all expenses incurred in earning such income notwithstanding the inconvenience the administration fears it would face in checking the accuracy and legitimacy of the expense deductions. The present prohibition of such deductions no doubt stems from unwillingness to face up to these administrative burdens, but in our view, with a tax that weighs as heavily as the personal income tax, administrative considerations should not be allowed to interfere with the equitable treatment of taxpayers. We also believe that all expenditures incurred for the purpose of earning income from a business should be allowed either as an expense deduction or by way of an annual capital cost allowance, except to the extent that they are (1) unreasonable in the circumstances, (2) personal or living expenses of the taxpayer—except travelling expenses and meals and lodging incurred while away from home in the course of carrying on the taxpayer's business, or (3) incurred for the acquisition of goodwill or of property such as land that is not consumed or does not depreciate in the income-earning process. We are particularly concerned with those amounts expended for the purpose of earning income from a business that are commonly referred to as "nothings". Decisions of the Tax Appeal Board and the courts focus attention on a great variety of such expenditures that are not allowable under the present Act:

for example, the cost of purchasing a construction contract, the cost of constructing an underpass under a highway that divided a farm into two parts, and the cost to a radio station of constructing a broadcasting gondola in a sports arena not owned or leased by it.

179. Various submissions to us have advocated a deduction for other taxes, particularly property taxes, in computing personal income. As indicated in Chapter 11, the relief afforded by such a deduction would be of greatest benefit to persons in high income tax brackets and of no benefit at all to persons who have insufficient income to be taxable. It would also be of no benefit to persons who rent their living accommodation, although there is little doubt but that the rents they pay reflect property taxes paid by their landords. The effect of allowing a deduction would be to add to the present regressiveness of the property tax—a condition that we found already to be sufficiently serious to warrant recommendations for relieving measures. Furthermore, to the extent that property taxes represent payment for services provided collectively to the owner of the property, there is no more justification for allowing their deduction in computing taxable income than there is for allowing the cost of services provided privately.

180. We favour an indefinite carry-over of a business loss sustained in one year as a deduction from business income of subsequent years, and a carry-back of the loss as a deduction from business income of the two preceding years, subject, however, to a continuation of the restrictions now in the Act.

181. The present Act, again in the interests of administrative convenience, prohibits the deduction of remuneration paid by a taxpayer to his or her spouse notwithstanding the services actually rendered by the spouse in the earning of the taxpayer's income. Similarly, where a business is carried on in partnership, a partner whose spouse is employed in the business is prohibited from deducting a proportion of the spouse's remuneration determined by reference to the proportion of the partnership business represented by his interest. The amount of remuneration to a spouse that is not allowed as a deduction is deemed not to be income of the spouse. Under another provision of the Act, where a husband and wife carry on a business in partnership the Minister of National Revenue has the discretionary power to deem the income of one spouse to belong to the other. We believe that the inequity so obviously inherent in these provisions should be removed. A spouse's remuneration paid for the purpose of earning income from a business should be deductible to the extent that it does not exceed what would have been reasonable in the circumstances if the employer and the spouse had been dealing at arm's length. Similarly, income of a husband and wife from a partnership business should be taxable against them in the proportions that would be reasonable in the circumstances if they had been dealing with each other at arm's length, and the discretionary power of the Minister to determine these amounts should be removed, leaving it to the courts to decide in the event that a taxpayer disagrees with his assessment. Of course, all of the problems involved in the treatment of husband and wife would disappear if they were taxed as an entity in the manner suggested below.

182. At the present time in Canada the unit of personal income taxation is the individual. In most countries of the world the various incomes of family members or at least of husband and wife are aggregated. The federal government has recently found it necessary to require a husband and wife to aggregate their incomes and then to deem the income of each to be half their joint incomes, for purposes of determining eligibility for the federal government's guaranteed minimum income plan—the plan that provides for an income supplement to Old Age Security pension recipients of up to $30 per month on a needs basis.

183. We are of the opinion that Canada should tax a husband and wife on their combined income according to a special table of rates. This would be done through the vehicle of a joint income tax return. We realize that the adoption of such a system would necessarily involve a restructuring of the rates of the tax to avoid a substantial reduction in revenue. Furthermore the schedule of rates should be so designed that the tax on the income of a married couple would be progressively greater than double the tax payable by a single person on one-half that amount of income. The rate schedules used in the United States result in a married couple who file a joint return paying the same amount of tax as if each had been taxed as a single person on one-half of their combined income. Assuming no change in the income base, the tax brackets or the degrees of progression in the rates from those now provided for Canadian income tax, a restructuring of the rates to compensate for the loss of revenue that would otherwise occur, and their application on the principle followed in the U. S. system, would result in substantially increasing the weight of the tax on single persons and on a husband and wife with approximately equal incomes. It would substantially reduce the weight of the tax on a husband and wife who had decidedly unequal incomes, the greatest reduction occurring where one of them had no income. While a reduction in tax for a married couple is the only purpose behind the concept of a joint return, care must be taken to ensure that this is not accomplished, as it would be if the U. S. system were adopted, by unduly increasing the burden on single persons.

184. We favour a continuation of a progressive rate structure but at reduced marginal rates. Our analysis in Chapter 5, on the incidence of government taxation and expenditure in Ontario, indicates that without some degree of progression in the personal income tax the net fiscal incidence of taxation in Ontario would be regressive. Consequently we would not advocate or support a change to a proportional rate structure. On the other hand, as we have indicated in Chapter 1, where we consider the principle of ability to pay "when the impact of all government fiscal operations, that is to say taxes and expenditures, on the individual are taken into account, it may well be that considerations of equity will call for personal income tax rates somewhat less progressive than at present." To this we would add that in our judgment the top marginal rate of 80 per cent (84 per cent on foreign investment income) represents virtual confiscation of income subject to the rate without adding significantly to the revenues of the country and certainly without adding to incentive or equity.

185. Because a progressive rate structure imposes a tax penalty on the recipient of fluctuating income, and because some amounts brought into income in one year may result from efforts or accumulations of a number of years, we think that a general provision that would permit averaging over time is necessary to mitigate the tax penalty inherent in a system that imposes progressive rates of tax on income realized in the arbitrary period of one year. We would look with favour upon a general averaging provision somewhat similar to that accorded persons whose chief source of income is farming or fishing.

186. Many problems of economic consequences, of equity and of compliance have arisen over the years from a system that taxes corporate earnings at corporate rates and corporate distributions to shareholders at personal income tax rates. Periodically, solutions such as those contained in Parts II, IIA, IIB and IIC of the Act, which impose reduced flat rates of tax on corporations in lieu of taxes on shareholders, have been enacted to meet specific problems. That these solutions have not been entirely successful is borne out by the enactment in 1963 of Section 138A, dealing with "surplus-stripping". We would welcome the closer integration of the personal and corporate income taxes, as an approach to solving this problem in a manner that is equitable, that produces a minimum of adverse economic effects, and that provides many fewer possibilities for tax avoidance. The Special Committee on Corporate Taxation appointed by the federal government in 1960 recommended in its report of March 21, 1961, a solution to this problem, but this has not been implemented.

CAPITAL GAINS

187. Under existing concepts of income in Canada so-called "capital gains" are not subject to tax. It is amply evident from the wide public interest shown in this aspect of the personal income tax that the question of taxing such gains is one of the critical issues of the day.

188. We do not propose here to review in detail the particular evolution of law and custom that has produced the present Canadian position. To cover this ground adequately would require devoting a disproportionate part of this report to the subject, and it has been dealt with frequently in other Canadian studies. Suffice it to say that as a result of our heritage of British and Canadian jurisprudence the scope of income tax in Canada has thus far omitted gains that do not arise from a trade or business, as these activities have come to be officially interpreted. In addition to gains that are truly "capital" in the sense of having arisen from the realization of a capital asset at an enhanced value, this exclusion has extended to such receipts as those arising from gambling and other types of casual or infrequent activity not associated with business or an employment. An immense amount of litigation has been devoted to delineating the boundary between taxable and non-taxable transactions, and a few guideposts have emerged from this process. Many businessmen and tax practitioners claim to be able to make a clear decision in nearly all cases on the basis of rules that can be derived from court decisions. Many others disagree, asserting that the rules appear to change from year to year,

with the result that many transactions are carried out in uncertainty as to their tax consequences.

189. This certainty—or lack of it—regarding the tax position of particular gains under the present régime is for some one of the major objections to the present law. However, for us there are other considerations of greater importance that must be taken into account. There is the crucial question of equity involved in exempting certain forms of gain from tax. Still another major issue relates to the economic advantages that result from the present position and the extent to which these would be lost or eroded under a different system. In the light of these questions it is relevant to examine tax practices elsewhere: how have countries other than Canada dealt with so-called "capital" gains?

PRACTICES IN OTHER COUNTRIES

190. We propose to deal with this last question first; a brief outline of the approach followed in countries of importance to Canada will serve to sharpen the specific issues of equity and economic effect to be discussed later.

191. The history of the United Kingdom is particularly revealing for Canada, our present approach having had its origins in long-standing custom and law of that country. Until recently, capital gains have been exempted in the United Kingdom as in Canada. With its short-term speculative gains tax of 1962 and the broader provisions introduced in 1965, the United Kingdom has become the latest country to tax such gains. The new tax establishes a distinction between long-term gains (on sales of property held over a year) and short-term gains (on sales of property held a year or less). The short-term gain is taxed as ordinary income, and the long-term gain is taxed according to a schedule of rates graduated so that the rate for any bracket applies to the whole gain, with a maximum rate for individuals of 30 per cent. Capital gains of companies are generally charged tax at existing income tax rates, with no offsetting credit to shareholders. In broad terms, the tax is charged on profits or gains from the disposal of any property, whether sold or given away. There is also a deemed realization on the death of a taxpayer, so that in effect his estate is subject to capital gains tax as well as death duties. One of the more novel features of the tax is that property held in trust is deemed to be realized and the deemed profit is taxed every fifteen years as well as on the termination of a life interest. In addition, the trust pays tax on any net gains realized in the year. Losses are computed on the same basis as gains, and the destruction of an asset is considered to be a realization. Exempt gains include those made on motor cars, the taxpayer's residence, some government securities and lotteries and betting. If business assets are replaced out of the proceeds of sale the gain is generally exempt. Transfers of a family business are granted reductions of tax. To aid enforcement, the administration is empowered to require information from brokers and investment houses regarding all trading in and issues of securities, from managers of commodity clearing houses regarding all their transactions, and from auctioneers and others regarding their dealings in tangible property.

192. A more familiar capital gains tax is that of the United States, which has been part of the income tax structure of that country since 1913. From the beginning, the United States took the broad view that any gain or profit is income, even though it may be of a capital nature. To meet the criticism that the taxing of these gains at progressive income tax rates was too oppressive, many special provisions were incorporated into the U.S. Internal Revenue Code. Perhaps the most notable of these is the one that distinguishes between long-term gains (on sales of property held more than six months) and short-term gains (on sales of property held six months or less). The short-term gain is treated as ordinary income, but the long-term gain is given special treatment, being taxed at half the regular rate, up to a maximum rate of 25 per cent. Within limits, capital losses are recognized as deductions and certain share exchanges and sales of residences are exempt on special terms. Finally, the U.S. law provides that a gift is not a realization to the donor or a capital gain to the recipient, although the donor's capital cost of the gifted asset is retained as the cost basis for the calculation of the donee's gain at the time he sells the asset. The cost basis for the calculation of any loss is the lesser of the cost to the donor and the fair market value of the property at the time of the gift.

193. Most European countries bring capital gains within the scope of income tax in some degree. Normally, high progressive marginal rates of tax have led the authorities to make concessions similar to those found in the United Kingdom and United States. In France, capital gains are classified as "extraordinary income" and may be spread over a period of years, to the extent that they exceed the average "normal" income of the taxpayer for the previous three years. In Norway, gifts, legacies, insurance, speculative gains on securities and profits on the sale of furniture are exempt. Switzerland exempts gains from lotteries. In Denmark, gains from involuntary realizations—that is, from the forcible taking of property by expropriation—are exempt. Finland generally exempts gains from property held more than five years and real property held more than ten years. Most of these countries permit losses to be deducted up to the amount of taxable gains. None of these countries taxes all gains from capital transactions at regular income tax rates.

194. Of the few countries that do not now tax capital gains, that of most interest for Canada is Australia. With a similar historical attachment and a strong reliance on British jurisprudence, Australia, like Canada, has maintained the position formerly followed in the United Kingdom. Apart from this notable exception, the general rule is that capital gains are now subject to tax in countries with relatively mature economies. This is not to imply that the tax is easy to administer, or that in the context of a typical Western Hemisphere tax system many compromises and concessions are not necessary.

THE QUESTION OF EQUITY

195. The equity arguments for a capital gains tax may now be examined. The chief such argument in favour of the tax is that there is no significant difference to

an individual whether his increase in economic power comes from a narrowly construed income base or from capital gains. It is claimed that the economic effect is the same and that equity demands that both be taxed uniformly. A demonstration of this argument is the position of the speculator as compared with a casual investor. Present Canadian income tax legislation taxes the profits of speculators as income from a business or an activity in the nature of trade, whether the profits arise from the sale of real estate, securities, or other forms of property. (In fact, the profits from real estate speculators have been singled out for more vigorous assessment than those from the sale of securities. This is a reflection on the administration of the law rather than on the law itself.) Those who support a capital gains tax ask what basic difference exists in equity between the profits received by such speculators and profits received from similar transactions (although perhaps less frequent or regular) carried on by persons who are not speculators. It is argued that if the gains of all persons from the sale of real estate and securities were brought into the ambit of tax there would be an increase in equity.

196. A secondary equity argument is that the difference between taxable and non-taxable transactions is, as already mentioned, obscure under present arrangements, and a knowledgeable taxpayer is more likely to be able to carry out his transaction in a form that will produce a tax-exempt gain than a less knowledgeable one. It is argued that to tax all capital gains will place all taxpayers on an even footing, thus increasing the chance of equitable treatment. Transactions having the same basic purpose and result would then not be taxed if carried out in one form and exempted if carried out in another.

197. As against these propositions in support of a capital gains tax as a measure to achieve equity it is argued that the tax itself creates new inequities, which can only be overcome by introducing extremely complicated compromises which detract from the goal of certainty. The inequities so introduced are said to arise from the following reasons:

(1) *The gain on almost any kind of investment may represent no more than a price increase caused by inflation.* This can, of course, be true whether the proceeds from the sale are reinvested or not. Opponents of the tax argue that many forms of investment are used as hedges against inflation, and that it is unfair to tax a person whose hedge has been successful. Such a tax would penalize people who are in effect "standing still" or even losing ground in terms of purchasing power. On the other hand, advocates of the tax point out that those people who make gains, even if only as the result of inflation, are in a better position than those who make none. Everyone is affected by general rises in price levels, and taxing gains can in fact reduce the disparity between those who realize such gains and those who live on taxed incomes, particularly when, because of progressive rates, one must pay a greater than proportional increase in tax on an increase in money income that may result in merely maintaining a constant amount of actual purchasing power or real income.

(2) *Under all existing systems tax is levied only when gains are realized, not as they accrue.* This gives an advantage to the person who is able to postpone taking his gain indefinitely, as against the person who for reasons beyond his control is forced to take his gain by realizing his investment. Fully equitable treatment would require that all gains be brought into income for all taxpayers from year to year as they accrued.

(3) *Often capital gains represent a profit which has not all been accrued in the year of realization but rather over several and perhaps many years, and progressive taxation levied on the sudden increase in the normal flow of income in the year of realization could inflict a severe and unfair tax penalty on the taxpayer.* Special treatment of capital gains to solve the problem, such as a flat rate or several rates, or a ceiling on progressive rates, or spreading the gain over a number of years, requires making a distinction, just as under the existing Ontario law, between capital gains and ordinary income. A further distinction is usually made to prevent the special treatment from being extended to the capital gains of speculators. The United States and other countries have attempted to resolve this problem by distinguishing gains on the basis of the length of time that the assets were held before realization. It is argued that such an arbitrary method of determining whether gains are wholly or partly taxable, without regard to all the circumstances relating to the transaction, seriously detracts from equity; and moreover it introduces complications that seriously detract from the certainty and generality achieved by the taxation of capital gains. On the other hand, without some kind of alleviation, the original inequity remains.

(4) *The inequities arising from the "realization" basis of capital gains taxation are further aggravated if property is permitted to pass to another person at death without a tax on the accrued lifetime capital gain.* The argument that it is sufficient to tax gains from gifts by gift taxes and from inheritances by death taxes fails on grounds of equity if the gifted property escapes a capital gains tax that would have applied had the property been sold. Persons situated equally are not being treated equally. The United Kingdom recognizes this fact and accordingly taxes the owner on all his capital gains both realized and accrued, at least once. The United States generally does not follow this practice.

(5) *Often a capital gain does not increase real economic power.* This is particularly obvious where the proceeds from the sale of a capital asset such as a home or business premises must be immediately used to acquire a replacement. One solution has been to exempt the gain except to the extent that the proceeds are not used to buy similar property as a replacement.

(6) *Often full deduction of capital losses is denied under a system of capital gains taxation.* Practical experience under existing actual tax systems does not encourage the view that the capital loss deduction will be as full and

as unqualified as the capital gain inclusion. The solution adopted by the United States is cited as an example. Capital losses in excess of capital gains for a year may be deducted from ordinary income of that year only up to $1,000, and from capital gains of that year and the succeeding five years until exhausted. For individuals, capital losses may be deducted also from ordinary income of the succeeding five years up to a maximum of $1,000 a year.

198. All these objections are serious. Features of a system of taxing capital gains that would be perhaps the most troublesome are the taxation of an accumulated gain in one year at full progressive rates and the taxation of gains only when realized. An alleviation of tax on an unusual receipt, given in specific terms for capital gains, introduces endless complications. Similarly, strict adherence to the realization basis can result in serious inequity. To meet these and other objections listed above, the minimum conditions for a capital gains tax would seem to be:

(1) some form of tax alleviation, either through a reduced rate or a method of smoothing or averaging, in such form as not to necessitate the separate identification of capital gains as such;

(2) a deemed realization of gains at death, in order to overcome in substantial part the inequities arising from deferral of tax on the accrued gains of a lifetime;

(3) full offset of capital losses against other income;

(4) moderation of the tax on those broadly owned types of asset in which forced realizations are likely to be common, the most general of all being the home of the taxpayer; and

(5) a form of reporting and a system of administration having the fewest possible complications.

ECONOMIC EFFECTS

199. In examining the economic effects of a capital gains tax one cannot be nearly as positive as could be wished. Perhaps the most convincing argument that such a tax will not have serious economic repercussions is the more than fifty years' experience of the United States with a capital gains tax that has not prevented that country from developing an extremely dynamic economy. On the other hand, all taxation has some effect in retarding economic growth, whether great or slight. A capital gains tax is a tax on the transfer of property, and is likely therefore to have some inhibiting effect on property transfers, an effect that would be somewhat reduced if it was shown that accrued unrealized gains would be taxable at death. Such a tax could thus reduce mobility of capital.

200. It is also clear that personal saving will be reduced by the effect of a capital gains tax, falling mainly on those higher income groups where the capacity for saving is greatest. The importance of this effect will depend on the relative weight of personal savings in the total savings of the economy, and probably could be offset by more favourable treatment for savings in other forms. It is also fair

to assume that a tax on realized gains could have the effect of dampening enthusiasm for investment and risk-taking, particularly in comparison with a situation in which no such tax was levied. It is questionable, however, whether this result would be as apparent after it came to be accepted that all gains from any of the available alternative avenues of investment would be subject to tax. In an economy like that of Ontario, mature in many respects but still heavily dependent on the capital formation, both from domestic and foreign sources, for the development of natural resources, the economic effects of a capital gains tax would have to be weighed very carefully against the advantage to be derived from such a tax.

CONCLUSION

201. From the foregoing considerations, we conclude that a capital gains tax should be approached with caution, and in no event by Ontario acting alone. All existing forms of this tax are fraught with many internal problems requiring arbitrary solutions, and it is doubtful whether the piecemeal grafting of any form of capital gains tax onto our present Canadian tax structure would make any significant contribution to equity. Even if the case in equity is made convincingly, it must be carefully assessed against the expected economic consequences. Consequently, we must advise that the levying of a capital gains tax by Ontario should be considered only if it is accompanied by a sweeping revision of the entire tax structure of such nature that the addition of capital gains to the tax base would make a clear and indisputable contribution to the equity of the whole revenue system.

Chapter 27

The Corporations Tax

INTRODUCTION

1. The Corporations Tax Act levies a number of taxes on corporations, some of which have persisted since 1899. The Act imposes:

(a) an income tax at a uniform rate of 12 per cent, similar to the federal levy on corporate income, but not identical;

(b) a place-of-business tax related to the number of permanent establishments that a corporation has in Ontario, payable by corporations other than those liable for the taxes referred to in (d) and (e);

(c) a tax on paid-up capital, including reserves and surplus, of corporations other than those referred to in (d) and (e);

(d) special taxes on banks, railways, telegraph companies, express companies and sleeping, dining and parlour car companies; and

(e) a special tax on insurance companies based on the gross premiums payable to them in respect of business transacted in Ontario.

2. The federal corporate income tax is abated by 10 of the 12 percentage points of the provincial tax on corporate income. This results in taxable corporate

profits attributed to Ontario operations bearing combined federal-provincial rates of 23 per cent on the first $35,000 and 52 per cent on additional amounts. The combined rates are the same in Quebec, and are 1 percentage point lower in Newfoundland, Manitoba and Saskatchewan and 2 percentage points lower in the other provinces.

3. The place-of-business tax, the tax on paid-up capital, and the special taxes other than that on insurance companies are payable only to the extent that they exceed the income tax. There are no federal counterparts to these taxes, although somewhat similar levies are imposed by the Province of Quebec. The Government of Quebec has before it a recommendation[1] for the abolition of that province's miscellaneous corporate capital taxes, which, unlike Ontario's levy, are payable in addition to that province's corporate income tax.

4. The insurance premiums tax is independent of the corporate income levy and is imposed in all ten provinces. Because we feel it should be judged by criteria different from those applied to the other taxes imposed under The Corporations Tax Act, it is dealt with in Chapter 31 of this Report.

5. The taxes levied under The Corporations Tax Act provide a substantial portion of provincial revenues. In 1966 they accounted for some $252 million, about 22.1 per cent of tax revenue, or 17.5 per cent of Ontario's total net ordinary revenue. Of the total corporations taxes, 91 per cent was derived from the 11 per

TABLE 27:1

REVENUE FROM TAXES LEVIED UNDER THE CORPORATIONS TAX ACT, ONTARIO, FISCAL YEARS 1961-66

(thousands of dollars)

	1966	*1965*	*1964*	*1963*	*1962*	*1961*
Income tax	229,833	213,654	192,302	169,118	148,871	170,584
Ordinary corporations						
Capital tax	2,329	2,814	1,894	2,100	1,441	1,297
Place-of-business tax	1,572	1,209	1,306	1,308	1,040	920
	3,901	4,023	3,200	3,408	2,481	2,217
Special taxes						
Banks	49	39	39	40	40	34
Telegraph corporations	15	12	12	15	15	15
Railways	525	433	416	374	349	376
Sleeping, dining and parlour car companies	—	1	1	1	1	1
Express corporations	22	6	17	15	13	29
	611	491	485	445	418	455
Insurance premium tax	18,031	14,375	13,685	12,747	14,084	12,411
Total	252,376	232,543	209,672	185,718	165,854	185,667

Source: Ontario, Public Accounts; and Treasury Department.

[1]Province of Quebec, Royal Commission on Taxation, *Report*, December 1965, p. 105, Recommendation V-17.

cent tax on corporate income (each percentage point yielding in that year some \$20.9 million), about 7 per cent from the levy on insurance premiums, and the balance—less than 2 per cent—from the capital, place-of-business and assorted special taxes. Table 27:1 sets out for selected years the tax revenues derived under The Corporations Tax Act.

HISTORY

6. The first form of provincial taxation on corporations in Ontario was introduced by The Supplementary Revenue Act of 1899. Quebec, in 1882, was the first province to tax corporations as such and its constitutional right to do so was upheld by the Privy Council in *Bank of Toronto* v. *Lambe* (1887) 12 A. C. 575. New Brunswick followed in 1892 and Prince Edward Island in 1894. Similar taxes had been levied in the U.S.A. as early as 1823.

7. The importance of this new source of revenue was soon realized and was stressed as early as 1905 in the Report of the Ontario Commission on Railway Taxation where it was said that:

> The problem of the taxation of corporations is a comparatively new one in Canada, but it is certain to continue to enlarge in importance and complexity, until it far overshadows all other aspects of direct taxation . . . In Canada we have every reason to expect that in time the greater part of the capital of the country will take the form of corporate property, and that the individual citizens will hold an ever increasing part of their wealth in the shape of corporate securities, representing either shares in enterprises, or loans to support or extend their business. Inasmuch, then, as the taxes which are required for the enlarging needs of the public service must be derived from the general wealth of the community, they must be levied in increasing measure upon a constantly expanding range of corporate property or income. For this reason the problem of corporate taxation has come to represent, if not for the present yet at least for the immediate future, the most important feature of direct taxation.

8. These early taxes were not measured by income or profits. Such a levy would have been impossible at that time since the undeveloped state of accounting made it difficult to determine the true income of a corporation. As a result, a special tax was imposed on the larger companies in certain well-defined categories, namely banks, insurance companies, loan companies, trust companies, railway and street railway companies, telegraph and telephone companies, gas and electric light companies, natural gas companies and express and sleeping car companies. These special taxes were later extended to race track companies and liquor export companies. No consistent base of taxation could be found for such a heterogeneous group and as a result a large number of bases were improvised to reflect the most effective manner of calculating and imposing a tax in the particular circumstances. Thus, banks were taxed on paid-up capital and places of business; insurance companies on gross premium income; railway companies and street railway companies on track mileage; and other companies mainly on paid-up capital or capital invested. Race track companies paid a flat rate per race meeting and liquor export companies were taxed at a flat rate per company. During the earlier years there

was no real attempt to make a proper allocation of the tax base to each province, particularly in respect of the tax on paid-up capital, and a degree of double taxation resulted.

9. Corporation taxes of the type imposed by The Supplementary Revenue Act are still in effect in much the same form in Sections 7 to 11 inclusive and Section 13 of The Corporations Tax Act. These are the alternative taxes levied on banks, railway companies, telegraph companies, express companies and sleeping car companies and the gross premiums tax payable by insurance companies.

10. Income taxes were imposed by municipalities in Canada before Confederation. This was provided for in the laws of various provinces, including Ontario, and the taxes were applicable at various times to both individuals and corporations. This type of tax was subject to considerable criticism on the ground that a municipality was too small an area to impose an income tax efficiently and fairly. Municipal income taxes gradually decreased in importance and were last imposed in Ontario in 1943.

11. British Columbia was the first province to impose a provincial income tax. It introduced a personal income tax in 1876 and a corporate income tax in 1901. In 1894 Prince Edward Island imposed a personal income tax, followed after the turn of the century by a corporate income tax. In 1923, Manitoba levied a personal income tax. During the 1930's all the other provinces began to tax the income of corporations, and by 1939 seven provinces had imposed personal income taxes. In 1917 the federal government introduced an income tax which was applicable to individuals and corporations generally.

12. In 1931 Ontario adopted a general paid-up capital tax at a rate of 0.1 per cent on all corporations except certain ones that were subject to other specific taxes. In the following year all such corporations were made subject to a tax of $50 for each office or place of business and a general profits tax of 1 per cent on net revenue. Authority was given to make regulations for allocating between Ontario and other jurisdictions the taxable capital and the net revenue of companies transacting business in Ontario and other provinces or foreign countries. In 1939 The Corporations Tax Act was repealed and re-enacted as The Corporations Tax Act, 1939. The new Act discontinued the special taxes that had applied to loan companies and liquor export companies but not those on other companies, and imposed taxes on offices and places of business, on paid-up capital and on net income of companies not subject to the special taxes. Hotels operated by railways were made subject to the taxes on places of business and net income. The tax on paid-up capital was reduced to 0.05 per cent. The rate applicable to net income was increased to 2 per cent and was further increased to 5 per cent retroactive to 1939 by a 1940 statute.

13. To accommodate the fiscal pressures created by World War II, the corporations taxes imposed by Ontario and all other provinces were suspended effective January 1, 1941, in accordance with wartime tax agreements between the federal and provincial governments. These agreements expired in 1947 and in that

year Ontario and Quebec revived their corporations taxes. Quebec has imposed and collected its own corporations tax continuously since that time. All the provinces except Ontario and Quebec entered into new tax rental agreements with the federal government in 1947 for a five-year period. Newfoundland made such an agreement for three years when it joined Canada in 1949. In 1952 and again in 1957, further tax rental agreements were entered into between these provinces and Canada. For the five-year period commencing in 1962, all the provinces except Ontario and Quebec imposed new corporate income taxes at the rate of 10 per cent for Manitoba and Saskatchewan and 9 per cent for the others, and entered into agreements under which the federal government collected these taxes on their behalf. Thus a new concept was established whereby each province became responsible for imposing its own tax, although where a province so elected the federal government assumed the responsibility of collection. These collection agreements are being extended for a further two-year period from 1967; and all of the agreeing provinces increased their rates of tax by 1 percentage point effective from January 1, 1967.

Table 27:2

SUMMARY OF MAJOR TAX RATES OF GENERAL APPLICATION SINCE THE INCEPTION OF CORPORATION TAXES IN ONTARIO

		Income	*Capital*	*Place-of-Business*
1899-1930	Special taxes on specific types of companies			
1931-1938		1%	0.1%	$50 each
1939-1940		5%	0.05%	$50 each
1941-1946		Suspended	Suspended	Suspended
1947-1951		7%	0.05%	$50 each*
1952-1956		Suspended	Suspended	Suspended
1957-1966†		11%	0.05%	$50 each*
1967		12%	0.05%	$50 each*

*For companies with paid-up capital of less than $100,000; the place-of-business tax per location is the same as the capital tax with a minimum of $20.00.

†Since 1957 the amount of tax payable on income has been deductible from the capital and place-of-business tax.

14. Reverting to the Ontario scene, during the period from 1947 to 1951 inclusive, taxes were imposed under The Corporations Tax Act, 1939 on substantially the same basis as during the period 1939-41 except that the rate of tax on net income was increased to 7 per cent. When the federal government negotiated new tax rental agreements with the other provinces (except Quebec) in 1952, Ontario entered into such an agreement. Accordingly, Ontario corporations taxes were suspended from 1952 to 1956 inclusive. In 1957, Ontario entered into a tax rental agreement with respect to individual income taxes but not with respect to corporation taxes. In that year the previous Ontario legislation was repealed and The Corporations Tax Act, 1957, was introduced, effective January 1, 1957.

15. The current statute has been in effect since 1957, although it has been amended annually since that time. Most of the amendments have been designed to keep the provisions under which the tax on corporate income is imposed uniform with those of the Income Tax Act (Canada). The effort to maintain uniformity in the determination of income and taxable income and in other respects has, to a large extent, been successful.

ADMINISTRATION AND APPEALS

ADMINISTRATION

16. The Corporations Tax Act is administered by the Treasurer of Ontario through the office of the Comptroller of Revenue and in particular through the Corporations Tax Branch of that office. We understand that the total staff of the Branch is approximately 186, of whom approximately 34 are assessors. About 20 employees are engaged in maintaining and revising the tax roll. Other personnel are engaged in such activities as accounting, filing, stenography and record-keeping.

17. The Branch has compiled a tax roll on which are listed all corporations that are or may be subject to tax. It is important that a tax roll be maintained since every corporation that has a permanent establishment in Ontario or a licence to hold land or carry on business in Ontario, or that carries on business in Ontario is subject to at least a place-of-business tax whether it has taxable income for the year or not. It is understood that in 1966 there were about 78,000 corporations on the Ontario tax roll. No figures are available on the number of such corporations that had taxable income.

18. In 1964 there were some 162,698 corporations in Canada, of which 102,442 reported a profit. Of the profitable corporations 87,209 were active taxable companies (excluding co-operatives and Crown corporations) and of these, 32,267 filed their returns in Ontario. The total taxable income of all corporations in Canada in 1964 was $4,371 million, of which $1,884 million or 43.1 per cent was allocated to Ontario.[2]

19. In the 1966 fiscal year the direct costs of operating the Branch amounted to approximately $955,000. On the basis of the total revenue of $252 million,[3] these costs of collection were approximately 38¢ for every $100 of revenue. The figures available for the Taxation Division of the Department of National Revenue for the 1965 fiscal year show a collection cost of 86¢ for every $100 of revenue.[4] However, this figure is for several reasons not comparable with the other. The federal costs relate not only to corporate income tax but also to personal income tax, non-resident tax and estate tax. The ratio of collection costs to revenue is also affected by the differences between the federal and provincial rates. Moreover,

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[2]Department of National Revenue, Taxation Division, *1966 Taxation Statistics*, Part Two, Ottawa: Queen's Printer, 1967.

[3]Ontario, *Public Accounts, 1966*.

[4]Department of National Revenue, Taxation Division, *Twenty-One Million Dollars a Day*, Ottawa: Queen's Printer, 1966, p. 32.

Ontario relies heavily upon and receives the benefit of much of the assessing work done by the federal authorities.

20. Ontario corporations tax assessors do not ordinarily visit the office of a corporation for the purpose of auditing its return. Returns are subjected to a desk audit. Information may be obtained as a result of a request for waiver of a lien on a corporation's property. Information may also be obtained from other branches of the office of the Comptroller of Revenue, from other departments of the Ontario government, or from other sources. Such information is taken into account in making assessments.

21. Until recently it was the practice of the Branch to require every corporation to file copies of all notices of reassessment issued to it under the Income Tax Act (Canada), but this is now done only when copies are not received direct from federal District Income Tax Offices located in Ontario. In this way the Branch benefits from knowledge of action taken by the federal authorities after such audits or investigations as they may have conducted. Also, a request may be made to a corporation for a statement reconciling any difference between the taxable income declared to and finally taxed by the federal income tax department and the taxable income reported on the Ontario return. Any further information or explanations required by the assessors may be requested by telephone or correspondence. Changes in taxable income or in its allocation that are made by federal reassessments are usually, though not always, adopted by the Ontario assessors. Sometimes, Ontario makes a reassessment where the Department of National Revenue has made none: for instance, where, on the basis of the facts obtained by it, Ontario assesses a gain realized from the sale of real property as income from business.

22. One of the consequences of the procedure outlined above is that there is usually a time lag between a federal assessment and corresponding action by the Ontario authorities. Assuming that the Branch considers a corresponding Ontario assessment to be warranted, it may issue such an assessment whether the taxpayer has objected to the federal assessment or not. If both jurisdictions have issued assessments and the taxpayer has objected to both, Ontario usually defers action on the objection until the federal objection or appeal has been disposed of, either by the Department of National Revenue or by the courts.

APPEALS

23. The Corporations Tax Act provides for a right of appeal to the Supreme Court of Ontario. The Income Tax Act (Canada) provides for an appeal to the Tax Appeal Board or the Exchequer Court of Canada. If appeals on the same point were instituted by a corporation under both statutes at the same time, it is possible that conflicting decisions would be arrived at. This is normally avoided by deferring an assessment under The Corporations Tax Act or action on a notice of objection under that Act or the hearing of an appeal under that Act until the appeal under the Income Tax Act (Canada) has been finally disposed of. The matter in dispute under the Ontario Act is then normally resolved by agreement between the parties on the same basis as under the federal statute.

CORPORATE INCOME TAX

DESCRIPTION

24. Every corporation with a permanent establishment in Ontario is required to pay a tax of 12 per cent on its taxable income. However, there may be deducted from that tax 12 per cent of the portion of the taxable income earned in each jurisdiction outside Ontario. The result is that the tax is imposed only on the taxable income that is regarded as having been earned in Ontario.

25. The Act contains rules for the allocation of taxable income between Ontario and other jurisdictions. There is a definition of "permanent establishment" which is relevant in applying the allocation rules as well as for other purposes of the Act. Generally speaking, the allocation rules are uniform with those contained in Part IV of the Income Tax Regulations (Canada) which are used to determine the provincial tax credit allowed under the Income Tax Act.

26. There is provision for the deduction of a "foreign tax credit" in respect of the tax paid to a jurisdiction outside Canada on "foreign investment income", consisting of dividends, interest, rents or royalties.

27. The Act permits a deduction from tax equal to one-third of the tax payable under The Logging Tax Act. Tax is imposed under that Act at the rate of 10 per cent on income in excess of $10,000 derived from logging operations. The Income Tax Act (Canada) provides in Section 41A that there may be deducted from the tax otherwise payable under that Act the lesser of (a) two-thirds of any provincial logging tax or (b) 6⅔ per cent of the taxpayer's income from logging operations in the province as defined in the Income Tax Regulations. Normally the full amount of the Ontario logging tax will be deductible from the taxes that would otherwise be payable under the Income Tax Act (Canada) and The Corporations Tax Act.

28. Investment companies that meet certain requirements pay tax at a special flat rate under Section 69 of the Income Tax Act (Canada). The tax payable by electric, gas and steam utility corporations is computed on a special basis under Section 85 of the Income Tax Act (Canada). However, all of these types of corporations obtain the normal provincial tax abatement under Section 40 of the Income Tax Act (Canada) and are taxed under The Corporations Tax Act in the same manner as ordinary corporations.

THE PROBLEM OF CORPORATE TAX INCIDENCE

29. The foregoing description makes clear that, under Canadian statutes, the corporation is viewed as an entity distinct from its shareholders and possessing its own capacity to pay taxes. Accordingly, the corporations tax is not considered to be a levy upon the shareholder's income, and dividends have, until the introduction of an initial 10 per cent dividends-received credit in 1949, been taxed in full as personal income tax. This procedure causes distributed corporate earnings to be taxed under both the corporate and personal income taxes, while the single levy at the corporate level upon retained profits is in no way related to the tax-paying

ability of the individual shareholder. It is thus apparent that our present tax structure does not impose the same tax liability on corporate earnings as it does on other categories of income, these latter usually being subject to the personal income tax alone.

30. Whether, for tax purposes, a corporation should be regarded as a completely separate entity with its own tax-paying ability or as a type of partnership, with its income attributed to its shareholders, is a question that has long been debated by students of public finance. When the pros and cons of the "separate entity" approach are examined, in conjunction with the perplexing question of tax shifting, it soon becomes apparent that theoretical grounds can be found for a very wide variety of recommendations concerning the taxation of corporations. This circumstance is explained by the rather obvious fact that any analysis of the equity and the economic effects of the corporate income tax must be related to the incidence of that tax, and by the further fact that while the long-run incidence of virtually any form of tax is uncertain, both the short-run and the long-run incidence of the corporate income tax are the subject of continuing debate among fiscal economists and businessmen alike.[5] Whereas among earlier writers it was generally agreed that the corporate tax was borne by the corporation, which is to say by its shareholders, present views now range from this one extreme of no shifting to the other extreme of virtually complete shifting. In no area of tax theory are conclusions so divergent.

Short-run Shifting

31. In analysing the incidence or ultimate location of the burden of a corporate income tax, its short-run effects are those that develop with sufficient rapidity to preclude any changes in plant capacity within the taxed industry; its long-run effects are those that emerge only over a period sufficiently protracted to have permitted changes to occur in the size of the industry. Given the nature of the distinction, any short-run shifting must take the form either of changes in the prices charged for the output of the corporate sector, or changes in factor prices paid by it.

32. Traditional theory has held that because a general corporate income tax would not, in the short run, be shifted, it would have no effect on either prices or levels of output. It was argued that under conditions of both monopoly and competition, firms would determine price and output in such a fashion as to maximize their profits. Since this required the equating of marginal revenue and marginal cost, neither of which is affected by a net income tax, it was concluded that the price and output levels that yielded maximum profits in the before-tax situation would continue to do so after the tax had been imposed. Alternatively, it was argued that a tax that took a constant percentage of a firm's net profits would not affect its optimum levels of output and price: whatever levels yielded the largest net income prior to the imposition of the tax would continue to do so afterwards.

[5]M. Krzyzaniak, *Effects of Corporation Income Tax*, Detroit: Wayne State University Press, 1966.

There would therefore be no shifting of the tax, and the short-run burden would rest upon the corporation, which is to say, upon its shareholders. It is this view that underlies the present taxation of corporate income in Canada, and it rests on a theory of incidence that has long since been demonstrated to be false.

33. This view regarding the short-run incidence of the corporate income tax has been much qualified by the recognition that where producers exercise some control over selling price, as they commonly do, a change in the tax may serve as a signal for price changes. For example, monopolists or price-leaders may aim not at short-run maximum profits but merely at a "fair" rate of return, the maintenance of which requires price increases when faced with corporate tax rate increases. Alternatively, fixed mark-up or full-cost pricing may be practised, firms typically looking upon the tax as an element to be included in calculating the full cost or the mark-up percentage. There has also been growing recognition that the profits tax may influence wage demands in collective bargaining. The short-run shifting suggested by these additional considerations constitutes a necessary qualification rather than an outright contradiction of the conclusion yielded by conventional price theory. These qualifications tend to support the long-standing scepticism of businessmen regarding the validity of the no-shifting conclusion. In many cases, possibly as a result of practising full-cost pricing and of applying conventional mark-up rates defined net of tax, taxes are treated simply as a type of cost, in determining selling prices. In such circumstances, it may be argued that the profits tax is in fact a form of sales tax levied on all goods and services, including food and other necessities of life, produced by profitable firms in the corporate sector.

Long-run Shifting

34. Where it is held that the corporate income tax is a levy upon pure profit (i.e., upon the excess of actual profit over that which would have been obtained from the next best use of the invested capital), the no-shifting conclusion arrived at for the short run is likewise applied to the long run. More realistically, the likelihood and nature of long-run corporate tax shifting will then depend upon the type of short-run adjustments occasioned by the tax. In particular, if one accepts the traditional conclusion that in the short run the tax reduces profits and lowers rates of return, then it would be expected to have an adverse effect in the longer run upon the rate of investment in the taxed industry. Yet the magnitude of this adverse effect on investment, as a consequence of the tax, is by no means certain, particularly if the tax bears uniformly on all incorporated enterprise and if proper provision is made for full loss offsets. Moreover, this degree of curtailment will depend upon the extent to which the flow of investment is affected by such factors as changes in the level of national income. Despite these reservations, the traditional view has held—perhaps inconsistently—that in the long run, investment in the industry would be curtailed by the tax, thereby tending to restore the previous rate of return to capital. The curtailment of investment would continue until such time as the before-tax rate of return had risen sufficiently to restore the net rate to its former level.

35. An important aspect of the corporate income tax that has so far been omitted from explicit consideration is the fact that it applies not to all profit income, but only to that part generated in the corporate sector. In consequence, where the tax is not shifted in the short run, the net rate of return on investment in the corporate sector will be lowered relative to that in the non-corporate sector. This alteration in the relative rates of return in the two sectors would tend, other things remaining equal, to alter the direction of the flow of capital, that to the non-corporate sector being increased at the expense of that to the corporate sector. An alteration of this sort would tend to raise the gross or before-tax rate of return in the corporate sector, while the increased flow to the non-corporate sector would tend to lower rates of return there. These changes, in turn, would tend to raise prices in the corporate sector relative to those in the non-corporate sector, and to change relative prices as between industries in a fashion determined by their differing degrees of reliance upon the corporate form of organization. By thus interfering with the flow of capital among sectors of the economy and by altering relative prices, a corporate tax that is unshifted in the short run tends to interfere with the efficient allocation of productive resources and to distort consumer choices.

36. Where the corporate income tax causes changes in the flow of capital such that rates of return tend to be lowered in the non-corporate sector, part of the burden of the tax will thereby be shifted to investors generally. Moreover, the actual allocation of the burden, as between income classes, will depend on the distribution not merely of equity holdings but rather of all financial assets. For example, should the relative importance of income from equity holdings be the same at all income levels, no shifting would occur: to the extent that investors succeeded in increasing the relative importance of dividends from equity holdings as a component of their total incomes, they would be damaged, *pari passu*, as recipients of other forms of capital income. If the burden of the tax is actually to be shifted, it is necessary that equity holdings differ in their relative importance as a source of income, as between income classes. Recent Canadian statistics[6] confirm the fact that dividends are relatively a much more important source of income at high than at low income levels. It therefore follows that to the extent that the corporate income tax is shifted in Canada by means of changes in flows of capital as between the corporate and non-corporate sectors, there will be a transfer of tax burden from relatively high to relatively low dividend-income recipients. Such a transfer would clearly be undesirable in the light of the widely-held view that equity in taxation requires progressivity in the distribution of tax burdens.

37. It is also necessary to note that where the corporate income tax alters the inter-sectoral flow of capital, it is likely that the sectoral allocation of other factors of production will also be changed. If these are less readily assimilated into the non-corporate sector than capital is, the owners of these other factors will also tend to bear some part of the tax burden as the re-employment of factors is brought about by reductions in the rates of remuneration for their services.

[6]Department of National Revenue, Taxation Division, *1966 Taxation Statistics*.

Statistical Evidence on the Shifting of the Corporate Income Tax

38. The inconclusiveness that characterizes the theoretical discussion of corporate tax incidence is also found in studies that have attempted to locate the burden of the tax by empirical investigation. The particular results yielded by studies are crucially dependent on the indicator used to measure shifting. Some indicators consistently demonstrate a high degree of shifting, while others lead to the conclusion that virtually the entire burden of the tax remains upon the corporation. Specifically, where the rate of return on investment has been used as the indicator of shifting, it has been found that the before-tax rate of return has risen with increases in the tax rate, the "after-tax" rate of return thereby being maintained. On the other hand, those investigators who have adopted as their indicator the gross or "before-tax" profit share of value added in the corporate sector have found this share to be relatively stable in the face of tax increases. They have therefore concluded that there has been no shifting of the tax.

39. The reconciliation of these conflicting conclusions is not conceptually difficult: a constant profit share is quite consistent with a rising rate of return before tax if there has been a sufficient compensating adjustment in the capital output ratio—in this case, a fall in the amount of capital required per unit of output. This formal reconciliation does not, however, solve the problem of whether the increased corporate tax rates absorbed gains in productivity that otherwise would have accrued to shareholders, or restrained the lowering of prices that would have benefited consumers. Given this uncertainty, the incidence of the corporate income tax must remain unknown. Where it is necessary to make some assumptions regarding its burden, the investigator must in the end choose whatever set of assumptions he considers most appropriate. The reader is reminded that the particular assumptions adopted by us represent something of the "middle ground" in the corporate tax incidence controversy. These assumptions have been detailed in our chapter relating to the net incidence of the Canadian fiscal system, and while they are necessarily somewhat arbitrary, they reflect an extensive study of the underlying issues.

40. We wish to repeat that while the issue may be an academic one from the standpoint of the collection of revenue, a clear picture of the incidence of the corporate income tax as among shareholders, customers and suppliers is essential to the formulation of a sound tax system. Without such knowledge concerning the burden of the tax, it is impossible to state with any degree of assurance whether such a tax enhances or detracts from the over-all equity of the system, however equity may be defined. Neither is it possible to state with any assurance whether the tax in question is more, or less, detrimental to the economy than some alternative method of raising an equivalent amount of revenue.

THE EQUITY OF THE CORPORATE INCOME TAX

41. The principle that income tax liability should be assessed in accordance with ability to pay is now widely accepted in this country. As we have pointed out in Chapter 1 of our Report, considerations of ability to pay relate to burdens borne

only by real persons, in the form of subjective sacrifices that they incur in parting with income. However imprecise the ability-to-pay doctrine may be, as a consequence of the difficulties inherent in the determination of taxable capacity, it is quite apparent that in this sense corporations have no ability to pay: their ability to pay is merely that of their shareholders. This doctrine is therefore seldom invoked in support of the corporate income tax.

42. While the ability-to-pay criterion is not inevitably bound to a system of progressive tax rates, such a linkage is widely supported. Thus, should it be concluded that the corporate income tax is shifted directly as a cost of production into the price of goods and services, it would be logical to judge it by the equity criterion used to judge a consumption tax levied on all goods and services, including food and other necessaries of life, produced by profitable firms in the corporate sector. There is little doubt that from this point of view a retail sales tax such as is imposed in Ontario, with food exempt, would be judged less regressive than a tax on corporate income. It could then be argued that it would be a step toward a more equitable tax system to replace revenues from the corporate income tax by higher retail sales tax rates, or to remove the corporate income tax from firms producing goods and services exempted under the retail sales tax, or to replace the revenues from the corporate tax with revenues from a higher level of income tax rates.

43. The appropriateness of the tax treatment, under the personal income tax, of both distributed and undistributed corporate earnings also depends upon the assumption made on the incidence of the corporate profits tax. If it is assumed that the corporate tax is passed on in its entirety, the imposition of the personal income tax on dividends cannot be considered "double taxation" of the same income in the same hands. In these circumstances, except as a means of encouraging incorporation or investment in corporate shares, there would be no equitable justification for any offset against full personal income tax rates on dividends, on account of tax paid at the corporate level. Strict adherence to the full-shifting hypothesis also leads to the conclusion that retained earnings of a corporation bear no tax until returned to the personal income stream.

44. When it is assumed, however, that no shifting of a corporate profits tax into prices occurs, and that the tax is borne by the shareholders, a different set of arguments concerning equity appears. Since the assumption that no shifting occurs underlies most corporate income taxes, these criticisms are well known and are often summed up in the term "double taxation of corporate income".

45. By being taxed at both the corporate and the personal levels, income generated within a corporation is, if no shifting occurs, generally subjected to a greater burden than is income from other sources. The amount of extra burden will of course vary, depending upon the amount of tax at graduated rates which that income would otherwise bear in the hands of individuals. Gross over-taxation and significant dis-incentive effects are said to result from this exposure of distributed corporate income to two sets of income taxes.

46. Not quite so frequently encountered, but still by no means rare, is a criticism primarily concerned with the retained portion of corporate profits. It is observed that these retentions may be used as a means of deferring or avoiding the application of the upper-bracket personal tax rates which distributions to high-income shareholders would otherwise encounter. In a country such as Canada, where there is no capital gains tax, this may be of considerable importance.

47. Although both of these points of view are relevant in evaluating the tax burdens on corporate income, it is apparent that, considered in isolation, each fails to provide an adequate base for such an appraisal. What is in fact necessary is the explicit consideration of *all* corporate earnings, whether distributed or not, and a comparison of the tax burdens imposed on this income (at corporate and personal levels) with those on equal amounts of income obtained from some other source. Such a comparison has recently been completed for Canadian shareholders, and it indicates that differential tax burdens (i.e., burdens which differ from those encountered by equal amounts of income from some other source) are typically encountered by dividend recipients.[7] The pattern of differential taxation that emerges is of some interest.

48. In the first place, if it is assumed that there is no shifting of the corporate income tax, almost all shareholders are over-taxed on both the distributed and retained components of corporate income. The rate of differential taxation, however, was found to vary inversely with the level of shareholder income, being greatest for low-income shareholders, and least for high-income shareholders. Indeed, for those few shareholders within the highest income brackets, the differential "burden" was actually found to be negative, both for distributed and retained corporate earnings, a fact that is to be explained by the rate of dividend credit exceeding the differential burden on dividend income and by the personal rate that would apply on distribution of retentions being greater than the corporate rate that these actually encountered. It should be noted that the few shareholders who experienced these negative "burdens" (in the no-shifting case, those with incomes in excess of $100,000) were the beneficial owners of a disproportionately large share of corporate income.

49. If, on the other hand, it is assumed that some part of the corporate tax is shifted, the general pattern of differential taxation is not altered: it was found that the highest differential rates are still encountered by low-income shareholders, while high-income shareholders enjoyed even greater negative burdens. The income level at which negative rates were first encountered moved further down the income scale the greater the proportion of the corporate tax assumed to be shifted. Should it be a substantial part of the corporate tax is shifted, then almost certainly the present tax structure imposes adverse differential burdens on the majority of shareholders, while undertaxing (relatively, that is, to other types of income) most corporate earnings—the two being quite consistent given the high degree of inequality of the holding of corporate equities. What is clear beyond any doubt is that if the no-shifting assumption of the corporate income tax is to continue to underlie

[7]John R. Allan, *The Income Tax Burden on Canadian Stockholders*, Toronto: The Canadian Tax Foundation, 1966, *passim*.

corporate income taxation in Canada, a fuller integration of the corporate and personal income taxes is called for, in order to achieve equitable treatment both as between shareholders at different levels of income and as between taxpayers deriving income from different sources.

ECONOMIC EFFECTS OF THE CORPORATE INCOME TAX

50. The levying of a corporate income tax may significantly affect the performance of the economy. Particularly interesting are its possible effects upon the level of investment, on methods of corporate financing and on the international competitiveness of industry in the country levying the tax. Judgments as to the particular consequence of the tax will, as we have already emphasized, depend to a large extent on one's assumptions relating to the incidence of the tax.

Effects on Investment

51. Where substantial short-run shifting of the tax is possible, significant adverse effects upon investment are not likely to appear. If, on the other hand, it is believed that little of the burden can be shifted in the short run, the imposition of such a tax will likely reduce the supply of internally generated funds available for investment. To the extent that dividend payments are not reduced, retentions will be smaller; and to the degree that investment depends upon the availability of internal funds, the level of investment will be reduced.

52. Given the sharp increases in corporate tax rates that have occurred in Canada since the inter-war period, one might therefore have expected an appreciable reduction in the capacity of the corporate sector for generating internal finance, with a consequent greater reliance upon external finance. In fact, this has not occurred. During the period of tax increases, the absolute level of after-tax profits has risen greatly, the fraction of these retained by corporations has increased, and data for the United States economy, where broadly similar conditions have prevailed, indicate that the relative importance of retentions in total financing has also increased. It seems not unreasonable to conclude, therefore. that increases in the levels of corporate tax rates have not had drastic repercussions on the availability of internally generated funds. To some extent, the absence from the Canadian tax structure of a capital gains tax, and the consequent very favourable tax treatment accorded share-price appreciations resulting from retentions, must help explain this result, for it has relieved corporate management from pressures for a more liberal dividend-distribution policy. It should be noted, however, that while retentions have increased, it is certainly possible that the gains might have been even more substantial had the tax increases not occurred. Unfortunately, this cannot be determined without a knowledge of how much larger net profits would have been in the absence of the tax. In other words, it cannot be determined without a prior resolution of the so-far insoluble incidence problem.

53. Even if the effect of the corporate income tax on retentions could be accurately established, its impact on investment would remain to be determined. While there is undoubtedly some relation between the availability of internally generated funds and the level of investment, it is most difficult to identify. In part,

the difficulty stems from the fact that retained earnings are closely related to the level of income and to profit expectations, both of which exert some influence on investment intentions. What nevertheless appears to be reasonably clear is that where the corporate income tax does affect investment via its effects on retained earnings, the impact is likely to be particularly severe upon small and growing enterprises. The owners of such firms are frequently reluctant to dilute control by resorting to the use of external funds. In addition, the availability of such funds is usually severely limited and involves relatively high interest costs.

54. Another possible effect of the corporate income tax may be that, through its impact on profitability, the incentives of management to undertake expansion are reduced. Since an *unshifted* tax lowers the net return available to the firm as a result of expansion, it is sometimes argued that the gain for surrendering liquidity and the return for assuming risk are lowered, with the result that less investment will be undertaken. Once again, the argument is somewhat more complicated. While it is true that the corporate tax may reduce the reward or price that is paid for assuming risk, it also lowers the total income of the investor. The former effect will tend to reduce the amount of risk-taking engaged in—i.e., it will tend to reduce the amount of investment—while the latter induces the investor to attempt to maintain his income by investing more. Theory cannot establish which of these two effects is more important, and thus whether or not investment must fall.

55: Moreover, it is by no means clear that the tax does in fact reduce the reward for risk-taking. Where an investor has other income against which a current business loss may be offset, a 50 per cent tax would halve the amount of risk. Since the reward from a profitable outcome would also be halved, the net effect upon the taking of risk would probably remain unchanged. Given the effects of loss offsets, and of the attempts by investors to maintain their incomes, the impact of the corporate income tax on investment may be much less severe than is commonly assumed.

56. Where it is believed that the effect of the corporate income tax on investment is adverse, because of its effect either on internal funds or on the incentives to invest, various incentive measures are available to restore or maintain investment. The most widely discussed measures include reduction in the rate of corporate tax, accelerated depreciation, and the investment credit. Under accelerated depreciation, the initial investment outlay may be depreciated very rapidly, the total amount eligible for depreciation being unaffected by the speed-up. With the investment credit, a given percentage of the initial outlay may be deducted from the tax liability; subsequently, depreciation deductions equal to 100 per cent of the initial outlay may be made. In effect, the credit may be thought of as a depreciation allowance in excess of 100 per cent of cost.

57. If the objective of relief is to promote a higher rate of investment, there is little to commend the device of reducing the corporate income tax. The benefit from such a reduction is distributed with respect to *total* profits, not to those profits attributable to new investment. The credit, on the other hand, applies only to new

investment, and the benefit from its use will therefore be distributed in proportion to new investment. Since accelerated depreciation may be limited to new investment or extended to all assets, its form must first be known before its effects on investment may be discussed. In general, where the objective is to promote a higher rate of investment at the cost of a given revenue loss, the use of an investment credit or of accelerated depreciation limited to new investment would seem to be the most satisfactory of these tax alternatives.

58. Among leading authorities in the study of public finance, there is substantial agreement that high marginal rates of corporate income tax lessen the incentive to efficiency in management, particularly in the control of expenditures, which tends to become less rigorous. The inevitable consequence is to affect adversely the allocation of productive resources and to lessen the efficiency of the country's economic performance. The importance of this effect should not be minimized in any evaluation of the tax.

Effects on Corporate Financing

59. Prominent among the criticisms levied against the present structure of the corporate income tax is the contention that it imposes a bias against equity finance by corporate enterprise. It is observed that while interest payments on borrowed capital are deductible in calculating taxable income, dividend payments to shareholders are not. In consequence, an undue reliance upon debt finance is seemingly invited, with the possible result that the corporate sector is rendered vulnerable to the hazards of fixed debt charges during periods of cyclical recession. It is also argued that by permitting firms to write off approximately half the cost of borrowing, they are not dissuaded from borrowing even by the high interest rates that typically accompany an anti-inflationary monetary policy. The control of inflation, it is contended, is thus made more difficult.

60. While plausible, the argument that the present tax structure causes an undue reliance on debt finance assumes that debt and equity instruments are highly substitutable forms of securities. In view of the very considerable difference in the degrees of certainty attached to the income yielded by various kinds of securities, this assumption is hardly correct, and the argument is therefore very easily exaggerated. In lending, many investors seek relatively riskless investments and this creates a definite upper limit upon the funds that any firm can borrow at a given time. The capital market thus imposes an effective external constraint upon the debt ratio of any corporation. Moreover, a supplementary internal constraint will likely be present.

61. Funds borrowed by a corporation are invested in ventures involving some degree of risk. This risk must be borne by someone, and, given the nature of their claims, it will typically be borne by the shareholders, not by the bondholders. Excessive reliance upon debt finance would thus tend to be self-defeating because the increasing risk accruing to the shareholder undermines the investment status of the company's stock. In the light of these considerations, it is most unlikely that present corporate tax advantages in Canada seriously distort the capital structure

of corporate enterprise. In support of this contention, it may be noted that in the United States, where financial data permit a more thorough investigation than can be made in Canada, and where the tax structure is broadly similar, year-to-year changes in the composition of corporate funds seem not to be related in any systematic manner to changes in corporate tax rates.

Effects on the Competitiveness of Canadian Exporters

62. The argument is frequently encountered that Canadian exporters are at a disadvantage vis-à-vis foreign competitors as a result of the high corporate tax rates that prevail in Canada. In support of this view, it is pointed out that many of the countries with which we compete internationally rely more heavily than does Canada on the use of indirect taxes. Since the General Agreement on Tariffs and Trade permits the rebate of these taxes on export sales, while denying comparable privileges to profits taxes, it is concluded that a relatively heavy reliance on direct taxes implies a competitive disadvantage. This, again, is a criticism of the corporate income tax (or at least of its role in the tax structure) that does not stand up well under scrutiny.

63. In the first place, it is difficult to criticize the Canadian tax structure on grounds of an excessive reliance upon direct taxation. While the export performance of France, where indirect taxes account for some 70 per cent of total tax yield, has been most satisfactory, there are several conspicuous counter-examples, notably Japan and West Germany, whose export performance is indeed enviable, and whose use of indirect taxation is relatively less intensive and of direct (corporate) taxation more intensive than that of Canada. More relevant, however, than the relative importance in the tax structure of the two broad types of taxes, is the extent to which they may be shifted and the rates that are applied.

64. Indirect taxes, constituting a cost of production, are subject to an export credit, and thus are not included in export prices. If, as is typically assumed, these taxes are reflected in increased domestic prices (i.e., are shifted forward), the effect of the export rebate will be to leave the prices, and so the competitive position, of exporters unchanged. If a compensating import duty is applied, as it usually is, import positions will also remain unaffected, and the indirect tax system, with export rebate and compensating import duty, will not affect the merchandise sector of the balance of payments. However, should the indirect taxes be to some extent shifted backward by means of reduced factor costs, the subsequent granting of the export rebate will tend to lower export prices. In addition, the compensating import duty would tend to restrict imports. The benefit to be derived from the use of indirect taxes thus depends on the extent to which they reduce the rate of increase of factor costs. Given the rigidity of many costs, and especially the downward rigidity of wages, it is doubtful that higher rates of indirect taxation convey a substantial competitive advantage to the countries using them.

65. The damage to the competitive position of exporters occasioned by the corporate income tax depends on the extent to which this tax is shifted. Where shifting is totally absent or slight, export prices are not adversely affected by the

tax; export rebates are thus not necessary to gain access to foreign markets. Should it be, however, that the corporate income tax is shifted forward domestically, in the form of higher prices for non-import-competing products, exporters would be at a disadvantage to the extent that the tax cannot be shifted on exports. Similarly, the producers of import-competing products would be at a disadvantage, the competition of imported goods preventing them from shifting the tax. Domestic shifting of the sort described thus enhances the relative attraction of producing for the domestic market.

66. From the foregoing discussion, it is apparent that the balance-of-payments case against the corporate income tax depends on the assumption that this levy is shifted forward, so as to be reflected in higher price levels. This will, of course, be as true for those European countries that use profits taxes as it is for Canada. If it may be assumed that the shifting behaviour is broadly similar elsewhere, the crucial determinant of the net disadvantage experienced by Canada is the differential between corporate tax rates in Canada and those encountered by our competitors. Since these tend to be small, or even in Canada's favour,[8] it is questionable that our use of the corporate income tax results in a substantial balance-of-payments disadvantage. It is probable, however, that the concentration of our trade with the United States makes it highly desirable that our corporate tax rates be prevented from rising above those of that country. By keeping our rates in line with those of the United States, adverse effects upon merchandise trade are avoided, as is the possible weakening of our ability to attract capital from the States.

67. This latter point is frequently debated in a purely domestic context. It is frequently contended, for example, that different rates of corporate taxation as among the provinces of Canada will influence the geographic distribution of real investment within this country. We have received no evidence that would sustain any firm assertion that the present combined rates of corporate tax in Ontario have had a marked influence on investors' decisions to avoid this province. Rates of corporate income tax are obviously only one of the factors entering investment decisions. For example, a better level of services, in part made possible by the higher tax rates, may, until the level of services is evened out across Canada, offset the effects of tax rate differences of the size now prevailing. On the other hand, common sense dictates that disparities in rates will have a marginal influence and if other major factors would permit an investment to be made in another province, a differential in tax rates could be enough to tip the balance. Over a long period—depending, of course, on the coincidence of other factors—an adverse differential will obviously not work to Ontario's advantage.

JUSTIFICATION FOR THE CORPORATE INCOME TAX

68. In our evaluation of the merits of particular kinds of taxes, we have consistently sought to include the criteria of equity, economic efficiency and yield. In

[8]For a comparative analysis of profit tax rates in selected countries, see Richard A. Musgrave and Peggy Brewer Richman, "Allocation Aspects, Domestic and International", in *The Role of Direct and Indirect Taxes in the Federal Revenue System*, Princeton: Princeton University Press, for the National Bureau of Economic Research and The Brookings Institution, 1964, p. 128.

our view, it is on this last score that the corporate income tax must find its strongest defence. Under present rate structures, it contributes almost one-quarter of the total tax revenue of the Canadian government and approximately one-fifth of that of the province of Ontario, where its yield is exceeded only by that of the retail sales tax and the personal income tax, and equalled only by that of the gasoline tax. The corporate income tax shares with the personal income tax and the sales tax a degree of responsiveness to economic conditions that enhances its value as a source of revenue during periods of expansion. Corporate tax revenue reflects changes in the level of corporate profits and, in an industrialized and growing province such as Ontario, the tax appears capable of providing a reliable and expanding yield in the foreseeable future. Thus, whatever the theoretical issues relating to its use, the corporation income tax seems likely to remain an essential and major source of provincial revenue, provided it is not overworked as a result of the comparative ease with which it can be collected and of the fact that it renders comparatively few voters unhappy.

69. In terms of equity, the corporate income tax can scarcely be defended for it cannot be shown to conform to the principle of ability to pay, regardless of any reasonable assumption concerning its incidence.

70. If the tax is assumed to be not shifted, then it is borne by the shareholders without regard to their individual financial circumstances. It is sometimes argued that the tax is at least *compatible* with ability to pay, since the importance of stockholding as a source of income increases *as one's income increases*, with the result that the corporate tax in fact adds an element of progression to the revenue structure. This element may nevertheless be easily overestimated in that if the corporate tax were reduced or removed any resulting increase in dividends would encounter the progressive rates of the personal income tax.

71. If the tax is assumed to be shifted to the buyers of the corporation's output or to the suppliers of its inputs, the distribution of the burden will be rather arbitrarily allocated according to particular market circumstances rather than with regard to the tax-paying abilities of the parties involved in the transactions. In the case of forward shifting, we have already suggested that in terms of conformity to ability to pay, a well-structured sales tax appears very much superior to the corporation income tax.

72. Given the present structure of the Canadian tax system, it can be reasonably argued that despite its lack of conformity to the principle of ability to pay, the corporate income tax does prevent even greater inequities than would be created by its removal. While much of the discussion of the taxation of corporate profits has emphasized the possible over-taxation of distributed earnings, a contrasting problem is posed by the possible under-taxation of retained earnings accruing to investors whose personal income tax rates exceed the corporate rate—a problem that is greatly accentuated by the two-step rate structure of the federal tax. In the absence of a corporate income tax, corporate retentions would escape all tax burdens until they became liable to personal income tax upon distribution. This

privilege of tax deferment would confer an important advantage on those in a position to benefit from it. The possibility of inequitable treatment is increased, where, as in Canada, there is no capital gains tax. In the absence of such a tax, it is certainly possible, through a policy of systematic reinvestment of earnings, to escape all taxes other than the corporate income tax, which impinges upon corporate earnings as they are earned and before they are reinvested. In the absence of both this tax and a capital gains tax, the resulting scope for tax avoidance would be intolerable in a system where other forms of income and in particular, wage and salary income, are taxed on a current basis.

73. In its over-all assessment of the corporation income tax, another commission of inquiry has found that the use of such a tax ". . . will be determined primarily by the current need for revenue and by the economic objects that it may be hoped to achieve by changes in the impact of taxation. . . ."[9] This is a view we strongly support. The rationale for this tax is thus reduced to its ability to satisfy revenue requirements and, through variations in its importance in the fiscal system, to facilitate the achievement of certain economic goals. We are aware that this tax is sometimes defended on grounds of benefits received by business through the privilege of incorporation and also on the proposition that such a tax is needed to enable the public to share directly in the monopoly profits of corporate enterprise. We reject these arguments as invalid, for essentially the same reasons as advanced by leading authorities in public finance.[10]

74. While post-war studies provide no clear demonstration that the particular use made of the corporation income tax has had adverse effects on economic performance, and while no such evidence is available for the Canadian economy, any generalized conclusion about the effects of the tax is quite unwarranted. What is clear, however, is that the tax fails to conform to principles of equity, and while the Canadian and Ontario governments have no practical alternative to its continued use in the short run, we firmly believe that the quality of the Canadian tax system will be substantially improved if, over a period of time, the role of the corporate income tax in the revenue structure can be very appreciably reduced. This would be possible only through the substantial integration of the personal and the corporate income taxes, within a much broader tax base designed to provide greater equity and fiscal productiveness. As indicated below, we attach great importance to uniformity in whatever tax base is adopted, as between provincial and federal income levies; and in recommending that the Province of Ontario lessen its long-run reliance on the corporate income tax, we therefore strongly urge that Ontario seek the co-operation of the Canadian government in working toward such an objective.

75. In the present state of knowledge about the incidence of a corporate profits tax we feel it would be unwise, even if practicable, for Ontario to consider any marked decrease in its reliance upon the corporate income tax, unless such a course

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[9]See Royal Commission on the Taxation of Profits and Income, *Final Report*, London: H.M.S.O., 1955, para. 57.

[10]See, for example, James M. Buchanan, *The Public Finances*, Homewood, Ill.: Richard D. Irwin, Inc., 1960, pp. 297-8.

were to be adopted generally throughout Canada. It should be recalled at this point that the Ontario levy accounts for 12 of the 23 percentage points (applicable to the first $35,000 of profits), and 12 of the 52 percentage points (applicable to profits over $35,000), of the combined federal-provincial rates of tax on corporate income in Ontario, so that the Province's ability to change significantly the economic effects of this form of tax by unilateral action is limited.

76. From a pragmatic standpoint, the saving feature of the issue is that virtually all jurisdictions with which Canada and Ontario companies compete levy taxes on corporate income, and thus their companies and residents suffer much the same consequences in both equity and economic effect as occur in Ontario and the rest of Canada. This, of course, is not a very satisfactory answer, but from it can be drawn one important point for practical tax policy. As long as the state of uncertainty exists concerning its incidence, the level of taxation of corporate profits in Ontario should be kept closely in line with the level prevailing in the rest of Canada. Moreover, Ontario, the province enjoying the benefits of the greatest concentration of corporate enterprise in Canada, should play a major role in seeing that the over-all level of tax on corporate income levied by both the provincial and federal authorities is kept in line with the levels in countries with which Canada has important trade relations.

77. Although we think that the maximum over-all rate of tax on corporation profits should not exceed its present level, the foreseeable revenue requirements of the Province prevent us from recommending that the rate differential in Ontario be eliminated by a reduction of the provincial rate. We hasten to add, however, that this opinion does not constitute an endorsement of any suggestion that Ontario indulge at any time in a round of competitive rate reductions. In any such competition, Ontario would in the end suffer, along with the less wealthy provinces which would feel forced to match, or possibly try to outdo, Ontario. In the long run, it is in the best interests of both Ontario and Canada that corporate tax rates play as small a part as possible in investment decisions.

78. In the circumstances of the present taxation of corporate income in Canada, we have seen the necessity of choosing between two major courses, the same two that the Province has faced in the past. The first is to attempt to devise recommendations that would result in a corporate income tax for Ontario based on what we considered was the combination of the best theoretical and practical considerations available, regardless of possible conflicts with the federal tax on corporate income. The second is to concur with the policy underlying the present corporate income tax in Ontario—i.e., uniformity with the federal levy.

79. Our conclusion is the obvious one: the corporate taxpayers of Ontario, and for that matter of Canada, will be far better served—as will the Government of Ontario—by seeking uniformity than by seeking improvements that would result in further divergences from the federal tax law. Although we have reached this conclusion, we have made it clear that we by no means approve of all the features of the present corporate income tax. We see considerable room for improvement in the federal Act and we trust that the recommendations of the federal Royal

Commission on Taxation will result in a number of desirable changes. We see uniformity simply as a necessary first step toward the improvement of corporate income tax law. Reduction in the number of avoidable conflicts should permit additional attention to be paid across Canada to difficulties that stem from differing basic accounting, legal, business and economic concepts.

80. A suggesion that uniformity can be preferable to a pursuit of perfection is not, we appreciate, a very heroic approach. However, an apt illustration of the wisdom of this approach is near at hand. The word "chaotic" has often been used to describe the tax situation in Canada in the 1930's. Each province and Ottawa had its own tax Acts and there were situations where two or more provinces would claim the right to tax the same income. It also appeared possible that some income would escape taxation in the maze. While the courts have from time to time considered the principles relating to the territorial "source" of income, the question of allocation of income to a jurisdiction is one on which there can be wide and valid differences of opinion. Frequently the taxpayer is the pawn in such debates, in a tug of war between jurisdictions for revenue. The taxpayer's position is usually that he does not care to whom he pays tax as long as he is not taxed more than once.

81. Should, for example, the jurisdiction where a product is manufactured have the primary right to tax profits? Should it be the jurisdiction where the product is sold? Or should it be the jurisdiction where the corporation has its head office? Arguments that the profit arises in each of these jurisdictions may be advanced. The situation is even more complicated with an airline, a pipe line, a telephone company, a bank and so on, where the business activity and its fixed assets of necessity extend across tax boundaries.

82. Suffice it to say that this type of problem, which for years marred Canada's tax scene, has gradually been solved by a process of give and take. The allocation rules have evolved to a point where, as applied by Canada, Ontario and Quebec, they are now to a large extent uniform, and they appear to be generally satisfactory to taxpayers, although complete uniformity would be better. There is, of course, complete uniformity in the allocation rules in effect under the Income Tax Act (Canada) and those in effect in the provinces (for which federal authorities collect the corporate tax) other than Ontario and Quebec.

83. While there remains considerable room for the discussion of the merits of the rules for allocating corporate income between provinces, we think that this is a prime example of an area where everyone is better served by uniformity. Changes in allocation rules, however well founded in principle, should be made only on the basis of agreement among all jurisdictions concerned.

84. Having reached the conclusion that in a federal state uniformity in taxation of corporations is a prerequisite to the pursuit of worth-while improvements, the next step is to consider how uniformity can best be achieved. Again, two courses are open. The Ontario Act can be amended, or Ontario can enter a collection agreement with the federal authorities for the collection of the corporate income

tax, in which case the tax rules must be the same as under the federal statute. We first consider the latter course.

ADVANTAGES OF A COLLECTION AGREEMENT

Uniformity

85. Perhaps the most desirable result of entering into a collection agreement with the federal government is that complete uniformity of the federal and provincial statutes with respect to the determination of taxable income earned in Ontario would be achieved. We have already discussed the merits of uniformity.

Reduction in Costs of Compliance

86. As a corporation would be required to complete only one return and to settle its federal and provincial tax liabilities with only one administration, its costs of compliance would be reduced.

Economy and Efficiency of Administration

87. The present duplication in the administration of corporate income taxes and therefore in costs of collection would be considerably reduced. It is estimated that for 1966, direct collection and administration costs for Ontario's corporation taxes amounted to $955,000. Much—though not all—of this would be saved under a collection agreement, if the Province, as we think it should, continued its interest in corporation taxes to the extent of examining duplicate copies of returns. While under the present form of collection agreement with a province, the federal government retains all penalties, fines and interest charged to delinquent taxpayers, this loss of revenue would be offset by the receipt of tax revenue when due, and by the elimination of the costs of prosecutions and appeals. A large part of the resulting savings would arise from the reduction in staff requirements of the Corporations Tax Branch. This would not occur immediately, because it would take several years for current assessments and collections to be completed. The acute need for competent tax administration in other parts of the Treasury staff such as the Sales Tax Branch precludes the possibility of present staff being left without challenging assignments. A key group of corporate income tax officials would be retained to examine copies of federal returns filed with the Province and to keep the provisions of the federal Act under scrutiny, in order to provide a basis for annual recommendations by the Comptroller to federal authorities.

Elimination of Bad-Debt Losses

88. Because the form of collection agreement between the federal government and the agreeing provinces provides for payments to be made to the provinces on the basis of assessments rather than collections, the agreeing provinces are relieved of all bad-debt losses.

Assurance of Additional Tax from Reassessments

89. For information on the basis of which to issue provincial reassessments, Ontario now relies on copies of notices of reassessment issued to a corporation by the federal government. Until recently, the Branch depended entirely upon the corporations to forward copies of the federal notices. Now copies are obtained

from the federal government of those notices of reassessment issued by federal District Income Tax Offices in Ontario. Any losses from a failure to receive advice of federal reassessments would be entirely eliminated by automatic assessment of provincial tax whenever and wherever a federal assessment is made.

DISADVANTAGES OF A COLLECTION AGREEMENT

90. From a corporation's point of view as a taxpayer, there appear to be no disadvantages to a tax collection agreement with the federal government. From the Province's viewpoint, however, there are several, which must be weighed against the advantages that we have considered. Each relates to the fact that a tax collection agreement, like any co-operative or joint venture (Confederation itself being the prime example), limits to some degree the scope for independent action.

Possibility of Rate Limits

91. We would consider any rigid limitation on the rate of tax that the Province could levy to be a serious disadvantage. We note, however, that a collection agreement in the form now used with an agreeing province does not limit it to a particular rate of tax. The provincial rate can be more than or less than the federal abatement. Any limitations that apply to tax rates stem from such practical considerations as the desirable over-all levels of tax as between the province and adjacent jurisdictions and the fact that the corporate tax field is occupied jointly by the federal and provincial governments.

Misallocation of Taxable Income among Provinces

92. The possibility exists that an Ontario tax administration may be more diligent than that of federal authorities in ensuring that the appropriate amount of taxable income is allocated to Ontario. The receipt of copies of tax returns and their scrutiny by provincial officials would permit a continuation of this diligence. It might be noted in this connection that from a corporate taxpayer's standpoint, the more uniform the over-all rates of corporate tax as among provinces, the less the incentive for a taxpayer to try to bend the allocation rules. With uniform tax rates, the question becomes one of concern only as among the provinces and there is no reason to suggest that federal authorities would wish to be guided by other than the settled rules of allocation.

Weaker Bargaining Position

93. Perhaps more important than the possibility of a limitation being imposed on tax rates is whether, by entering into an arrangement that would in time result in disbanding the Province's corporate tax collection organization, the Province would place itself at a disadvantage in future tax-sharing negotiations. It is our understanding that such a fear has had some past bearing upon Ontario's decisions concerning corporation tax agreements. We do not discount the fear. In our view, a collection agreement should not be entered into unless some means is developed for Ontario to receive a copy of the federal returns, as well as assessments, and to participate in annual consultations with the federal authorities on tax law and collection procedures. With such arrangements, the Ontario personnel required to keep abreast of the collection system would provide a nucleus of highly trained

people which should permit this province to return rapidly to its own collection of the corporate tax if future bargaining relations between the federal and provincial authorities make this step unavoidable. We trust, of course, that federal-provincial tax-sharing or collection arrangements do not reach the point where the mere existence of collection machinery would constitute an important consideration in negotiations.

Loss of Autonomy over Tax Base

94. A somewhat more difficult question relates to federal initiative in providing tax incentives for various specific and regional economic purposes. In view of the wide differences of opinion that exist about the desirability of such measures, it would be only realistic to expect that federal and provincial authorities would hold varied opinions on the merits of specific proposals. Entry into a collection agreement would necessitate the unqualified adoption of the present and future provisions of the Income Tax Act (Canada) for the determination of taxable income earned in Ontario. In this area, there is no escaping the fact that a collection agreement limits the scope of decision-making in provincial fiscal policy. In weighing this factor, however, it should be recalled that the main effect of federal provisions is now felt by Ontario companies regardless of whether Ontario adopts federal provisions. Federal provisions will, in one sense, at current tax and abatement rates, be roughly 77 per cent[11] effective in any event for the larger companies paying at the 52 per cent marginal rate. Even now it is difficult for Ontario to resist going along with federal policy changes that it may not approve of, through the laudable provincial policy of seeking to maintain a uniform tax base. The federal authorities could demonstrate their interest in facilitating the development of collection agreements by accommodating the provinces on matters of concern to them.

95. A federal offer to sponsor regular consultation between federal and provincial tax authorities at both the policy and technical levels would be most helpful in this connection. We are satisfied that traditions of budget secrecy need not stand in the way of such consultations. To the extent that they do, they have no place in a modern federal state. A further step would be for federal authorities to offer any incentive measures thought desirable in the form of deductions from tax otherwise payable, rather than as adjustments to the tax base. In this way, individual provinces in collection agreements could determine for themselves whether they wished to co-operate in specific tax incentive measures, and to what extent.

96. The development of genuine federal-provincial consultation processes in the formulation of tax law policy would, we hope, render unnecessary provincial concern about the loss of autonomy and legislative authority.

CONCLUSION

97. After carefully weighing all of the above factors, we are of the opinion that

[11]After provincial abatement, the federal tax of 40 percentage points represents 77 per cent of the 52 per cent marginal rate.

it would be in the best interests of Ontario to seek a collection agreement that provides for the safeguards discussed above. *We therefore recommend that:*

Ontario seek an agreement with the federal government for the collection of corporate income taxes under which **27:1**

(a) a copy of each federal corporate tax return of a corporation incorporated in Ontario, having a permanent establishment in Ontario or carrying on business in Ontario, and all notices of assessment thereof, would be made available to the Treasurer of Ontario, either by the federal government or by the taxpayer's filing, and

(b) the federal authorities would undertake

(i) upon written request of the Treasurer of Ontario to conduct an audit of an Ontario taxpayer's return and advise the Treasurer of the results, and

(ii) to consult regularly with the Treasurer of Ontario on the desirability of any proposed changes in the structure of the tax or its yield to the Province.

FEDERAL-PROVINCIAL CONSULTATION ON THE TAX BASE

98. The foregoing recommendation that Ontario seek a corporation income tax collection agreement is conditional on the federal government's agreeing to consult the Treasurer of Ontario on proposed changes in the structure of the tax and its yield to the Province. We believe that the Province should also continually strive to persuade the federal authorities to remove both present inequities and those that may develop later, in the structure of the federal tax, whether the Province enters into a collection or agreement or not.

99. As we stated in the preceding chapter concerning personal income tax, we did not commission any studies on the structure of federal income tax, this being the subject of a thorough analysis by the federal Royal Commission on Taxation. However, we express in that chapter some general views concerning several matters relating to the tax base that have equal application to corporation income tax. We refer particularly to the need for assuring that all reasonable expenditures incurred for the purpose of earning income from a business, except personal and living expenses, should be allowed either as an expense deduction or by way of an annual capital cost allowance (according to their nature) unless they were incurred for the acquisition of goodwill or of property such as land that is not consumed or does not depreciate in the income-earning process.

100. We also indicate in Chapter 26 that we favour an indefinite carry-over of a business loss sustained in one year as a deduction from business income of future years, and a carry-back of the loss as a deduction from business income of the two preceding years, subject, however, to a continuation of the restrictions now in the Act.

101. We state further in that chapter that we would welcome, as an approach to solving the problems of income retentions and surplus-stripping, the closer integration of the personal and corporate income taxes in a manner that is equitable, that produces a minimum of adverse economic effects, and that provides many fewer possibilities for tax avoidance.

102. In Chapter 26, we also consider the whole question of taxing capital gains, and we express the view that it is doubtful whether the piecemeal grafting of any one of the present forms of capital gains taxes onto our present Canadian tax structure would make any significant contribution to equity.

TRANSFER TO PROVINCE OF FEDERAL TAX ON UTILITIES

103. Under special legislation enacted in 1966,[12] the federal government remits to a province 95 per cent of the federal tax paid by each electric, gas or steam utility corporation on the part of the income earned after December 31, 1965, that is attributable to its utility operations in the province. Thus a province, in addition to the provincial corporation income tax, now receives virtually all of the federal tax on such utility income. Under a similar arrangement for prior years, 50 per cent of the federal tax was transferred to the provinces. The decision to increase the transfer to the province was in response to representations from several provinces that privately owned gas and electrical utilities were still at a competitive disadvantage vis-à-vis publicly owned utilities, and that customers of privately owned utilities were similarly placed at a disadvantage. The provinces argued that the continuation of this disadvantage would oblige them to consider the nationalization of these utilities.[13]

104. While the federal tax transfers are unconditional, the Minister of Finance, when moving the resolution to introduce the 1966 legislation, expressed his hope that the provinces would use them for the benefit of the public utility industry and its customers.[14] Because of the time lag involved in assessing the federal tax and determining the provincial sharing, the federal transfers are not made until the third year following the year in which the profits are earned. Ontario has not yet indicated what its policy will be regarding the transfer that it will receive in 1968 in respect of 1966 federal tax. For prior years, when the transfer was at the rate of one-half the federal tax, rebates were not made by the Province to the utility corporations. The revenue received from the transfer amounted to $1.3 million for the 1966 fiscal year. On this basis, the revenue for a year when the transfer represents 95 per cent of the federal tax would be $2.5 million.

SHARING OF SPECIAL FEDERAL CORPORATE TAXES

105. The federal government now collects a number of special taxes from corporations under Parts II, IIA, IIB and IIC of the Income Tax Act (Canada). These taxes are designed mainly to exact a corporate tax under circumstances

[12]The Public Utilities Income Tax Transfer Act, S.C. 1966, c.43.
[13]*House of Commons Debates,* June 23, 1966, p. 6823.
[14]*Ibid.,* p. 6824.

where there might be an eventual avoidance of personal tax revenue on particular forms of corporate distributions or reorganizations, or to permit a corporation to elect to pay a tax so that it might make a tax-free distribution to its shareholders. In our view, the provinces should share in the revenue from these special taxes. As they are in effect largely in substitution for personal taxes, we make such a recommendation in Chapter 26.

NON-RESIDENT WITHHOLDING TAX

106. We have considered whether the Province should also seek from the federal authorities a share of the taxes imposed on non-residents under Parts III and IIIA of the federal Income Tax Act or alternatively to impose similar taxes of its own. The taxes under Part III are generally referred to as non-resident withholding taxes. The tax under Part IIIA is an additional 15 per cent tax on the business income earned in Canada by a non-resident corporation imposed because its shareholders are not subject to the 15 per cent non-resident withholding tax on their dividends from income earned in Canada. In equity, as between the federal and provincial jurisdictions, we feel there is a case to be made for provincial participation in these taxes. In Chapter 26, we suggest that the federal yield from these taxes could be shared with the provinces by the federal government making payments (at the rate of the federal abatement of corporation income tax), allocated on the same basis as corporate business income is allocated among the provinces for the year. In that chapter, we recommend that Ontario press for a provincial sharing of such taxes during the renegotiation of any future fiscal arrangements with the federal government.

ALTERNATIVE INCOME TAX RECOMMENDATION

107. Because our main recommendation involves the negotiation of several principles with federal authorities, it is obviously not open to the Province to implement the recommendation by unilateral action. This being so, it is necessary to consider how the present Ontario corporate income tax legislation can be improved if a collection agreement is not concluded. As indicated throughout our discussion of the corporate income tax in Ontario and Canada, we regard the elimination of differences between the basic provisions of liability for tax and computation of what constitutes taxable income—apart perhaps from special incentive provisions—as essential for the proper and fair application of this tax. It perhaps goes without saying at this point that except where there can be shown to be major effects on provincial revenues or major clashes in tax policy principles, the taxpayer has a right to be relieved of the inconvenience, the extra costs of compliance and the perils of uncertainty that can arise from what the non-technical observer might consider as being inconsequential differences between the tax laws of federal and provincial taxing jurisdictions.

108. It might be asked at this point, assuming that the Ontario and federal statutes can be made virtually identical, what advantage accrues to the taxpayer from a province's entering a tax collection agreement. The answer is that as long as there are two administrations collecting a corporate income tax, differences of

opinion will arise over the tax implications of a given set of facts and over the most appropriate interpretation of even identical—or virtually identical—provisions.

109. The best that can be done, therefore, in the absence of a collection agreement and the use of the same taxing provisions, is to limit as far as possible the room for conflict in the provisions themselves. As we have indicated previously, as far as the application of the income tax portion of The Corporations Tax Act is concerned, provincial authorities for the most part deserve credit for their efforts to eliminate inter-jurisdictional differences between the federal and provincial levels of government. This is not always easy, given some of the essential differences between the scopes of the two jurisdictions, and in fact in some areas it is necessary to have apparently dissimilar provisions in order to achieve a similar end result. Some of the provisions of the federal Act are not necessary in the Ontario Act because the Ontario statute requires a single rate of tax.

110. In the Appendix to this chapter there appears a list of almost fifty provisions of The Corporations Tax Act and the Corporations Tax Regulations relating to the determination of taxable income, or taxable income earned in Ontario, which differ in substance from the corresponding provisions of the Income Tax Act (Canada). These differences, and such others as from time to time emerge, should be eliminated as quickly as possible. It is particularly important that uniformity in the provisions for allocating taxable income among provinces be maintained. Most of the differences are relatively unimportant to the revenue of the province, because it is doubtful that provincial treatment differs significantly from that of the federal government, in all the circumstances that the Ontario Act requires. However, such differences do leave the taxpayer in an uncomfortable position.

111. To eliminate the variations referred to in the Appendix and, we believe, to reduce if not eliminate the need to pass retroactive legislation each year in order to maintain uniformity with the federal statute, *we recommend that:*

In the event that Ontario does not enter into a corporate tax collection agreement with the federal government, The Corporations Tax Act be amended to provide that **27:2**

(a) every corporation shall pay a tax at the rate specified, computed on its taxable income earned in the year in Ontario as determined under the provisions of the Income Tax Act (Canada) and the Regulations thereunder, except as otherwise specifically provided in The Corporations Tax Act;

(b) all discretions exercised by the Minister of National Revenue under the Income Tax Act (Canada) shall be deemed to have been exercised by the Treasurer of Ontario unless the Treasurer exercises a discretion, when the determination made by the Treasurer shall prevail;

(c) all elections made by a taxpayer under the Income Tax Act (Canada) shall be deemed to have been made for purposes of The Corporations Tax Act unless otherwise specifically provided in that Act; and

(d) every corporation required to file a return under The Corporations Act (Ontario) shall file with the Treasurer each year a copy of its return filed under the Income Tax Act (Canada), and a copy of every election, pension plan or other document filed with the Department of National Revenue under any provision of the Income Tax Act (Canada).

112. We have been advised that the above recommendation is constitutionally feasible, in relation to provincial legislative powers provided by the British North America Act.

113. We nevertheless reiterate that the elimination of variations in the tax law does not necessarily mean that the determination of taxable income or its allocation would always be identical, since differences of opinion between federal and provincial administrators on the way facts and provisions should be interpreted could still arise.

PAID-UP CAPITAL AND PLACE-OF-BUSINESS TAXES

114. Before 1952 the taxes on paid-up capital and places of business were additional to the income tax. Since 1957 the income tax has been deductible from the paid-up capital and place-of-business taxes. The result is that the taxes on paid-up capital and places of business are paid only by inactive companies, and by active companies that have losses or very little income. Rules are provided for the computation of paid-up capital and taxable paid-up capital. The paid-up capital of a corporation for a fiscal year is its paid-up capital as it stood at the close of the fiscal year, including the paid-up capital stock of the corporation, its earned, capital and other surplus, all its reserves (except any reserve the creation of which is allowed as a charge against income under Part III of the Act), all sums or credits advanced or loaned to the corporation by any other corporation except a bank, and all its indebtedness represented by bonds, bond mortgages, debentures, etc. The determination of the paid-up capital of taxable foreign corporations is governed by special provisions set out in Section 5 (16).

115. In determining its taxable paid-up capital, a corporation is entitled under Section 69 to deduct certain amounts in respect of goodwill, discounts allowed on the sale of shares, investments in securities and amounts invested in mines and related plant and works. The deduction in respect of goodwill and other intangibles included in a corporation's balance sheet may be claimed only to the extent that, in the opinion of the Treasurer, these are overvalued. In any event, the deduction is limited to 50 per cent of the book value of the goodwill or other intangibles. It appears from the corporation tax return forms that this deduction is determined

in practice under an arbitrary formula based on average net income for a five-year period. The deduction in respect of investments in securities has the effect of preventing double taxation of the same capital in the hands of two or more companies. The deduction in respect of discounts allowed on the sale of shares applies only to mining corporations. The deduction of amounts invested in mines and related plant and works is apparently designed to provide relief to unprofitable mining companies with substantial investments in mines and mining equipment.

116. As the tax payable under Section 5(1) is based on all of a corporation's taxable paid-up capital, a deduction from tax is allowed under Section 5(3) of an amount equal to 0.05 per cent of the portion of the taxable paid-up capital that is deemed to be used in each jurisdiction outside Ontario. Thus, if the only permanent establishments of the corporation are located in Ontario, all of its taxable paid-up capital is deemed to have been used in Ontario. Conversely, if the corporation has no permanent establishment in Ontario, all of its taxable paid-up capital is deemed to have been used in jurisdictions outside Ontario. Where the corporation has permanent establishments both within and outside Ontario, the taxable paid-up capital is allocated to the various jurisdictions on the basis of gross revenue and salaries and wages. The determination of gross revenue and salaries for the purposes of this tax is governed by the same provisions as apply to the allocation of taxable income for the purposes of corporate income tax. Likewise, the special allocation rules for trust and loan corporations, grain elevator operators, bus and truck operators, pipe line operators, navigation companies, and airlines are similar to those applicable to the allocation of the taxable income of such corporations for income tax purposes. Section 5 does not contain a provision comparable to subsection (33) of Section 4, which is applicable where separate parts of the same business fall within different categories for purposes of allocation.

117. No provision is made for reducing the tax on paid-up capital where the fiscal year of the corporation is less than twelve months. The full rate of tax is payable whether a corporation carries on business during a fiscal year or not.

118. Corporations that are exempt from the corporation income tax are also exempt from the paid-up capital tax. The paid-up capital tax is not imposed on certain banks and types of corporations such as railways which are subject to special taxes. The place-of-business tax is payable by all corporations except those subject to the special taxes.

119. The Act provides that every corporation having a permanent establishment in Ontario shall for every fiscal year pay a tax of $50 for each such establishment in Ontario. It is further provided that the tax is to be calculated on the maximum number of places of business open during the fiscal year of the corporation for which the tax is imposed. If an agent is acting as such for more than one corporation, each such corporation is deemed to have a permanent establishment in the office or place of business of the agent. However, permanent establishments are deemed to be separate permanent establishments only where each of them is

located apart from the others and apart from the head office or executive office of the corporation. Where a corporation closes one permanent establishment and subsequently opens another, the second permanent establishment is not taxed until the following fiscal year. Corporations are subject to the tax for every fiscal year whether they have carried on business during the year or not. And the full rate of the tax is payable even if the fiscal year is less than twelve months.

120. Although the basis of the tax is the existence of a permanent establishment, a corporation that does not have a permanent establishment in Ontario may nevertheless be liable for an equivalent tax. A corporation without a permanent establishment in Ontario is required to pay a special business tax of $50 for each fiscal year if it:

(a) merely holds assets in Ontario; or

(b) merely maintains in Ontario an office solely for the purchase of merchandise; or

(c) merely possesses a licence under The Mortmain and Charitable Uses Act; or

(d) merely holds a licence under Part IX of The Corporations Act.

A corporation without a permanent establishment in Ontario but carrying on business in Ontario within the meaning of Section 346 of The Corporations Act is liable, in addition to any other taxes imposed upon it, to pay a tax of 0.1 per cent, calculated on the total amount of its gross sales made to, or its gross revenue received from, customers residing in Ontario, with a minimum of $5 and a maximum of $50.

121. In a number of cases a reduction is made in the rate of tax payable. For corporations with a paid-up capital of less than $100,000, the rate of tax is 0.05 per cent of the paid-up capital for each permanent establishment in Ontario. However, under this provision the total of the taxes on places of business and paid-up capital cannot be reduced below $20. Certain mining corporations and corporations that have not commenced to do business or have ceased to do business, and are entirely without assets, pay a place-of-business tax at the flat rate of $20 instead of $50. A special reduced rate of $5 is payable by most of the classes of corporations, such as charitable organizations, that are exempt from other taxes under the Act. This reduced rate has not been extended to mutual insurance corporations, personal corporations, foreign business corporations or farmers' and fishermen's insurers, nor to municipal authorities, non-profit corporations for scientific research or housing for the aged corporations.

122. The continuance of the capital and place-of-business taxes in their present complex form cannot be readily justified. Their nuisance value is too high in relation to the revenue yield, particularly since they too are now payable only to the extent that they exceed the tax on income. While we recognize the point that they have some value to the administration as a means of identifying, for the purpose of assuring that the income tax is not evaded, incorporated enterprises

doing business in Ontario, we note that federal authorities and authorities in other jurisdictions manage without this form of impost. These levies are particularly annoying to those foreign corporations whose connection with Ontario or Canada is remote. A common complaint of a company which, for example, "merely holds assets in Ontario" is that the cost of compliance may far exceed any tax payable.

123. An amount of revenue equivalent to the yield from the present complex capital and place-of-business taxes could be obtained by a simple annual corporate business tax payable by a corporation, whether or not it was also subject to provincial income tax, at an amount fixed without regard to the number of places at which it carried on business. We suggest that such a tax should be imposed on every corporation that has a permanent establishment in Ontario and on every corporation without a permanent establishment in Ontario that maintains in Ontario an office solely for the purchase of merchandise, or possesses a licence under The Mortmain and Charitable Uses Act or Part IX of The Corporations Act. A business tax of $50 on each of the 78,000 corporations on the tax rolls in 1966 would have yielded the same amount as collected in capital and place-of-business taxes for the Province's 1966 fiscal year. However, as it is desirable to provide a reduced rate for charitable organizations and other corporations exempt from corporate income taxes and for corporations entirely without assets that have not commenced to do business or have ceased to do business, a tax of slightly more than $50 would be required from corporations taxable at full rates to maintain the same yield. We do not suggest any higher rate of tax as we are concerned not to add to the costs of carrying on business in Ontario by increasing the present over-all level of taxation on business both for competitive reasons and because, to the extent that taxes on business are shifted, they bear relatively more heavily on persons with low incomes. The rate selected should, of course, be reviewed from time to time in the light of conditions then existing.

124. So long as Ontario continues to collect its corporate income tax, the annual corporate business tax could be imposed under The Corporations Tax Act and collected by the Corporations Tax Branch. If, as we recommend, an agreement is made for the federal collection of Ontario's corporate income tax, we suggest that the annual corporate business tax should be collected through the Department of the Provincial Secretary together with the annual filing fee payable under The Corporations Information Act. Provided that there is appropriate liaison between the office of the Provincial Secretary and that of the Treasurer, this procedure need not diminish, and in fact should enhance, the value of information in corporate returns for tax administration. As a practical means of keeping the Treasurer informed, we suggest that the annual return to the Provincial Secretary should provide for a duplicate copy or tear-off sheet for the Treasurer. This would be a final step in achieving a considerable and worth-while consolidation and simplification of Ontario's corporate tax structure.

125. For the reasons expressed above, *we recommend that:*

The present capital and place-of-business taxes under The Corporations Tax Act be replaced by an annual corporate 27:3

business tax of fixed amount payable, without any reduction for corporate income taxes, by every corporation now liable for the present taxes; and that the amount of the tax be fixed at the rate or rates needed initially to yield approximately the same revenue as derived from the present taxes.

We further recommend that:

Upon entering into any agreement with the federal government for the federal collection of Ontario's corporate income taxes, the proposed annual corporate business tax be collected, together with the annual filing fee under The Corporations Information Act, by the Department of the Provincial Secretary. 27:4

SPECIAL TAXES

126. In addition to the taxes of general application referred to above, an array of dissimilar special taxes is imposed on particular types of corporations. These are as follows:

BANKS

127. Banks are liable for (a) a tax of 0.2 per cent of the paid-up capital stock and 0.1 per cent on the reserve fund and undivided profits; and (b) an additional tax of $3,000 for the principal office in Ontario and $200 for each additional office, branch or agency in Ontario but for those open fewer than 250 days in the fiscal year, one tax of $200 applies for each 250 days or fraction thereof that they were open. The Treasurer is authorized to reduce the amount of tax according to (a) above, where the head office of the bank is outside Ontario and there are not more than five offices, branches or agencies of the bank in Ontario. However, the tax cannot be reduced under this provision below 0.1 per cent calculated on one-half of the paid-up capital stock. It is notable that where the bank has more than five offices, branches or agencies in Ontario, the taxes referred to in (a) above are based on the entire paid-up capital reserve fund and undivided profits, and not merely on the portion thereof used in Ontario. The revenue from the tax for the 1966 fiscal year amounted to $49,000.

RAILWAYS

128. Railway corporations are taxed on the basis of mileage of track operated or used in Ontario. The rates vary according to the number of tracks on the line, the length of the line and the nature of the territory through which the line passes. The tax was formerly imposed in respect of ownership of track, as well as operation or use, but this was changed in 1957 to exclude ownership as a basis of tax. The rates are: $60 per mile of single line; $40 per mile of additional lines except that (a) for track outside an organized municipality the rates are $40 and $20; (b) when the railway is 150 miles or less in total length the rates are $15 and $5; (c) when the railway is 30 miles or less in total length, the rates are $10 and $5. And

when the railway exceeds 150 miles between termini, additional rates of $25 and $20 apply. The revenue from the tax on railways amounted to $525,000 for the 1966 fiscal year.

TELEGRAPH COMPANIES

129. Corporations that own, operate or use a line or part of a line of telegraph in Ontario for gain, including corporations that own, operate or use a railway, are required to pay a tax of 1 per cent on the total amount of money invested in such line and the plant and works connected therewith. The tax is shared between the owner corporation and the user corporation where these are not the same. Revenue of only $15,000 was received from this tax for the 1966 fiscal year.

EXPRESS COMPANIES

130. Corporations that carry on the business of an express company over a railway in Ontario, including corporations that own, operate or use a railway, are required to pay a tax of $800 for each 100 miles of railway or fraction thereof up to but not exceeding $10,000. Revenue for the 1966 fiscal year from this tax was $22,000.

SLEEPING, PARLOUR AND DINING CAR COMPANIES

131. Corporations, other than railway corporations, that transact in Ontario the business of operating, leasing or hiring sleeping or parlour or dining cars run upon or used upon any railway in Ontario are required to pay a tax of 1 per cent, calculated upon the money invested in such cars in use in Ontario. The revenue from this tax has amounted to very little in the six-year period from 1961 to 1966, averaging only $556 for the first five years; nothing has yet been collected for 1966.

INSURANCE COMPANIES

132. While it is customary to consider with the above taxes the levy on insurance corporations of 2 per cent of gross premiums in respect of business transacted in Ontario, this special tax, which yields a considerable amount of revenue and which is imposed by all provinces, can be judged by different criteria from those applied to the other special taxes and it is therefore dealt with elsewhere in this Report. The revenue for the 1966 fiscal period was $18 million.

CONCLUSIONS

133. With the exception of the 2 per cent tax on insurance premiums, we regard the special taxes applicable to banks, railways, telegraph companies, express companies, and sleeping, parlour and dining car companies, as the clearly vestigial remains of another era. They are in fact recognized as such in current legislation. It will be recalled that since 1957 these have been payable only to the extent that they exceed the tax on income. We are aware of no substantive argument in favour of their retention. They are arbitrary measures and their yield is uncertain, since their applicability can be wiped out by the income tax levy. For the six fiscal years 1961 to 1966 inclusive, the average of the revenue was $412,000 from the special tax on railways and $72,000 from all the other special taxes except the insurance

premiums tax.[15] In our view, the yield is in no way commensurate with the nuisance value of these taxes, and *we therefore recommend that:*

The special taxes under The Corporations Tax Act applicable to banks, railways, telegraph companies, express companies, sleeping car, parlour car and dining car companies be repealed, and such corporations be subject to the recommended annual corporate business tax. 27:5

SUMMARY

134. The foregoing historical sketch and description of present tax provisions reveals the evolution of corporate taxation in Ontario from a series of levies based on criteria deemed most appropriate for a particular kind of business into what is at present mainly a tax of general application, the amount of which is determined by the profits or income of the corporation. This evolution was fostered by the growing demands for revenue and made possible by developments in accounting techniques. In the course of this evolution, the significance, in revenue terms, of the original levies withered, but, as is often the case in taxation, the levies themselves did not disappear, or become fully integrated into a rational system.

135. Our recommendations in the corporate tax field are designed to complete the evolution toward a comprehensive corporate income tax. In order that this may occur it is necessary that the vestigial remains disappear and that other levies be moved from The Corporations Tax Act into other parts of the Province's revenue and licensing fee structure and that these levies be reshaped in accordance with criteria appropriate to the circumstances.

RECOMMENDATIONS CONCERNING ADMINISTRATION AND APPEALS

136. In the event that Ontario does not enter into an agreement with the federal government for the collection of the Province's corporate income tax, certain improvements in administrative and appeal procedures are needed. While, in principle, uniformity of the statutory provisions relating to such procedures is as desirable as uniformity in substantive provisions, as a practical matter it is not as necessary and, in fact, with respect to appeal procedures it may not always be possible.

137. It should nevertheless be recognized that because a greater amount of scrutiny has been given the federal Act over the years, as a result of its being applicable across Canada, a number of provisions have been refined that could with advantage be followed under the Ontario statute if the Province continues to collect its own tax. Other changes are, in our opinion, desirable in themselves, without reference to the federal statute.

138. Since our appointment, we have been advised that an arrangement for the exchange of information has been reached between federal and provincial revenue authorities. This should result in improved assessment procedures for both parties.

[15]Table 27:1.

We think that Ontario should effect a similar working arrangement with the Province of Quebec, the only other province that administers its own corporate income tax.

139. In Chapter 25, which is devoted to administrative and appeal procedures relating to all provincial revenues, we make recommendations concerning corporation and other provincial taxes, including recommendations:

(a) for the prohibition, except for fraud or misrepresentation, of any reassessment after the expiry of six years from the date of the first or original assessment, except where an intergovernmental tax collection agreement may specify a shorter period of time;

(b) for the issuance of certificates of no claims for lien;

(c) for the establishment of a Board of Appeals to hear objections to assessments;

(d) for an appeal to the High Court of Justice for Ontario in respect of an assessment, with or without first having a hearing before the Board of Appeals; and

(e) for an application to the Supreme Court of Ontario for the waiving of a statutory time limit for an objection to or appeal of an assessment.

We believe that our proposals, if accepted, would achieve a much-needed uniform appeal procedure for all of Ontario's tax and revenue imposts, and one that would be particularly appropriate to corporation taxes, especially if Ontario continues to collect its own taxes.

140. There are certain administrative and other matters concerning only corporation taxes that we consider here. These have to do with obtaining judgments for uncollected taxes, searches and seizures, solicitor-client privilege, and a statutory time limit on the commencement of prosecutions.

141. The Treasurer of Ontario is empowered under the Act, with the approval of a judge of the Supreme Court, to authorize an officer on the Comptroller of Revenue's staff to enter and search any building, receptacle or place for documents, books, records, papers or things that may afford evidence as to the violation of any provision of the Act or the Regulations and to seize, take away and retain any of them that are discovered until they are produced in court hearings. This power is almost identical to that of the Minister of National Revenue under the Income Tax Act (Canada), which he has often exercised. The existence of this provision in its present form represents a potential danger to the civil rights of taxpayers, in that a person whose documents are seized has no right to have the action taken reviewed by a court of law, to inspect and list the seized documents, or to obtain the return of the seized documents upon substitution of properly identified photo copies. *We therefore recommend that:*

The provisions of the Ontario Corporations Tax Act relating to searches and seizures be amended to provide safeguards to **27:6**

protect the rights of a person whose property has been seized by giving him the right

(a) to apply to a court for a review of the action taken,

(b) to inspect and list the seized documents, and

(c) to obtain the return of seized documents upon the substitution, where practical, of properly identified, clear photo copies of such documents.

142. For more than ten years, the Income Tax Act (Canada) has provided a procedure whereby a solicitor-client privilege can be claimed and established in respect of any documentary communication between a client and his lawyer in professional confidence. Where an officer authorized by the Minister of National Revenue is about to examine or seize any such document in the possession of a lawyer, the lawyer may claim on behalf of his client that the document is privileged. The officer must then seize the document without examining it, seal it in a package and place it in the custody of the county or district sheriff or other mutually acceptable person. An application is then made to a judge for an order determining the question of the privilege. No such provision appears in The Corporations Tax Act. In our view, the failure to provide sufficient means for the meticulous observance of solicitor-client privilege is prejudicial to the interests of a taxpayer. *We therefore recommend that:*

Provision be made in The Corporations Tax Act for a procedure to be followed when solicitor-client privilege is claimed in respect of documents that are demanded or seized. 27:7

143. The federal Income Tax Act provides that a prosecution must be initiated within five years from the time that the matter arose or within one year from the day on which sufficient evidence to justify a prosecution came to the knowledge of the Minister of National Revenue, whichever is the later. No similar provision appears in The Corporations Tax Act.

144. In our view it is desirable that the time for commencing a prosecution be limited so that a person may not be exposed indefinitely to the possibility of being prosecuted for an alleged offence. The federal provision seems reasonable except that the day on which sufficient evidence came to the knowledge of the Minister of National Revenue is conclusively determined as certified by him, a procedure that may deprive a taxpayer of any realistic protection. *We therefore recommend that:*

The Corporations Tax Act provide that a prosecution for an offence under the Act must be commenced within five years from the day on which the matter of the information or complaint arose or within one year from the day on which an officer of the Branch first had sufficient knowledge to justify a prosecution for the offence. 27:8

Appendix to Chapter 27

LIST OF PROVISIONS OF THE CORPORATIONS TAX ACT AND THE CORPORATIONS TAX REGULATIONS WHICH RELATE TO THE DETERMINATION OF TAXABLE INCOME OR TAXABLE INCOME EARNED IN ONTARIO AND WHICH DIFFER IN SUBSTANCE FROM THE CORRESPONDING PROVISIONS OF THE INCOME TAX ACT (CANADA) AND THE INCOME TAX REGULATIONS (CANADA)[1]

(1) The definition of *corporation* contained in Section 1 (1) 8 of The Corporations Tax Act is more extensive than the corresponding definition contained in Section 139 (1) (h) of the Income Tax Act (Canada). It includes an agent, assignee, trustee, liquidator, receiver or other official who has control over property of a corporation, but does not include a corporation incorporated without share capital, whereas the federal definition includes only an incorporated company.

(2) Section 1 (1) 16 of The Corporations Tax Act, which defines *fiscal year,* appears to give the Treasurer a discretion to direct a change in the usual and accepted fiscal year of a corporation. The corresponding definition of *fiscal period* contained in Section 139 (1) (r) of the Income Tax Act (Canada) does not provide for such discretion.

(3) The terms *individual* and *person* are not defined in The Corporations Tax Act, while they are defined in paragraphs (u) and (ac) respectively of Section 139 (1) of the Income Tax Act (Canada). These terms include the legal representatives of a deceased person under the Income Tax Act (Canada) but probably do not under The Corporations Tax Act. This may have importance under subsections (3), (6) and (7) of Section 1 of The Corporations Tax Act, which provide for the circumstances in which corporations are related and accordingly are deemed not to be dealing with each other at arm's length.

(4) The term *property* is defined in Section 1 (1) 30 of The Corporations Tax Act in a different way than it is defined in Section 139 (1) (ag) of the Income Tax Act (Canada). The definition in The Corporations Tax Act includes every interest or profit of certain specified types that arise out of or are incident to property while the corresponding definition in the Income Tax Act (Canada) does not. On the other hand, the definition in the Income Tax Act (Canada) includes a share or chose in action. These items are not included in the Ontario definition.

(5) Subsections (3), (3a) and (4) of Section 139 of the Income Tax Act (Canada) provide that in certain circumstances an individual is deemed to have been resident in Canada. There are no corresponding provisions in The Corporations Tax Act. This difference may be of importance in determining whether a

[1]The differences listed in the Appendix are those existing as at October 1, 1966, that were not eliminated upon the enactment of the 1967 amendments to The Corporations Tax Act.

corporation qualifies as a personal corporation under Section 42 or as a non-resident-owned investment corporation under Section 45 of The Corporations Tax Act.

(6) Section 139 (4a) provides rules relating to the residence of any corporation incorporated in Canada. These rules are not reflected in The Corporations Tax Act. This may be of importance in interpreting a number of provisions, including subsections (1) and (1a) of Section 40, relating to the deduction of dividends received.

(7) Section 139 (7) of the Income Tax Act (Canada) provides that a non-resident person is deemed to have been carrying on business in Canada if he has done certain things listed in paragraphs (a) and (b) thereof (which are referred to herein as "paragraph (a) transactions" and "paragraph (b) transactions" respectively). The Corporations Tax Act does not contain a provision like this but provides in Section 2 (8) that a non-resident corporation is deemed to maintain a permanent establishment in a place if it carries out any paragraph (a) transactions in that place. The Income Tax Regulations (Canada) do not provide in Section 400 (2) that such transactions will result in a corporation having a permanent establishment in a province.

Accordingly a non-resident corporation that conducts paragraph (b) transactions in Ontario may be subject to Canadian income tax but not Ontario corporation tax. Such a corporation that conducts paragraph (a) transactions in Ontario may be subject to Canadian income tax and Ontario corporation tax but may not be entitled to a provincial tax credit under the Income Tax Act (Canada).

(8) Section 2 (1) of The Corporations Tax Act provides that the expression *permanent establishment* includes branches, mines, oil wells, farms, timber lands, factories, workshops, warehouses, offices, agencies and other fixed places of business. The corresponding definition contained in Section 400 (2) of the Income Tax Regulations (Canada) defines the expression as "a fixed place of business of the corporation, including an office, a branch, a mine, an oil well, a farm, a timber land, a factory, a workshop or a warehouse . . .". The juxtaposition of words might result in a difference in meaning. Under the Federal Regulations a branch, etc. would not constitute a permanent establishment unless it is also a fixed place of business whereas under the Ontario Act it might. The Ontario definition includes "agencies", while the federal definition does not.

(9) Section 2 (11) of The Corporations Tax Act provides that if a corporation has no fixed place of business it will have a permanent establishment in the place designated in its charter or by-laws as being its head office. Section 400 (2) of the Income Tax Regulations (Canada) does not contain such a provision.

(10) Section 3 (3) of The Corporations Tax Act provides that where a corporation ceases to have a permanent establishment in Ontario during a fiscal year it will pay taxes as though its fiscal year ended on that date. On the other hand a corporation that is resident in Canada at any time in a taxation year is subject to tax under Section 2 (1) of the Income Tax Act (Canada) on its taxable income for the entire year.

(11) Section 4 (6) (d) of The Corporations Tax Act provides for the attribution of gross revenue where the customer has instructed that shipment be made to some other person. It differs from the corresponding provisions contained in paragraphs (d) and (e) of section 402 (4) of the Income Tax Regulations (Canada). However, the general effect of the provisions appears to be substantially the same.

(12) Several paragraphs in subsection (6) of Section 4 of The Corporations Tax Act (which relates to the allocation of gross revenue between jurisdictions) contain exceptions and cross-references to other paragraphs of that subsection. The corresponding provisions of the Income Tax Regulations (Canada) do not contain similar cross-references. This may be relevant in determining which provision is applicable in case of conflict.

(13) Section 4 (6) (h) of The Corporations Tax Act and Section 402 (4) (i) of the Income Tax Regulations (Canada) provide for the allocation of gross revenue derived from the sale of standing timber or the right to cut standing timber. The Ontario provision allocates the revenue to the permanent establishment which "includes the timberlands" while the federal provision allocates it to the permanent establishment of the taxpayer in the province or country in which the timber is standing. The Ontario provision takes account of the possibility of the timberland's not being included in a permanent establishment of the corporation. This would be possible if the corporation does not own the timberland but has only the right to cut timber.

(14) Section 4 (34) of The Corporations Tax Act contains rules for allocating the taxable income of a corporation that is incorporated under the laws of a jurisdiction outside Canada. Section 413 of the Income Tax Regulations (Canada) contains corresponding provisions relating to a corporation that is not resident in Canada. A corporation that is incorporated outside Canada may be resident in Canada and accordingly the Ontario provision may apply in cases where the federal provision does not. Moreover, the rules contained in the two provisions are not the same.

(15) Section 4 (37) of The Corporations Tax Act provides that a corporation will be exempt from income tax for a fiscal year during which it complied with certain conditions. Section 62 (1) of the Income Tax Act (Canada) provides that no tax will be payable upon the taxable income of a person for a *period* during which that person complied with certain conditions. Such a period may presumably be less than a fiscal year. Accordingly, if a corporation complies with the necessary conditions during a period which is less than a fiscal year it may be exempt from income tax for that period under the Income Tax Act (Canada) but subject to corporate income tax in Ontario. Subsection (38) of Section 4 of The Corporations Tax Act purports to provide for the determination of taxable income for a period that is part of a fiscal year. This provision does not appear to have much significance because of the wording of subsection (37).

(16) Section 4 (37) (j) of The Corporations Tax Act, which provides for the exemption of credit unions, differs from section 62 (1) (k), the corresponding provision of the Income Tax Act (Canada). A corporation will qualify for exemp-

tion under these provisions if its revenues are derived primarily from certain sources and its members are certain types of corporations or associations. The federal provision relates to credit unions incorporated under provincial legislation and the specified sources of revenue include bonds of or guaranteed by a province. Section 4 (37) (j) refers to credit unions incorporated under legislation of Ontario and the corresponding source of revenue is bonds of or guaranteed by the Government of Ontario.

(17) Section 4 (39) (b) of The Corporations Tax Act and Section 62 (3) (b) of the Income Tax Act (Canada) provide that there will be included in computing the income of a non-profit corporation all gifts received by the corporation, with certain exceptions. One of these exceptions is a gift by a person who was not taxable under the statute in question or in respect of which the donor has not been allowed a deduction as a charitable donation under that statute. Where the donor is an individual, he may have been allowed a deduction under the Income Tax Act (Canada) but not under The Corporations Tax Act, which does not apply to individuals. Accordingly, a gift by an individual which was allowed as a deduction under the Income Tax Act (Canada) may be included in the income of the corporation under that Act but not under The Corporations Tax Act.

(18) Section 17 (1) of The Corporations Tax Act brings into income amounts received as legal costs awarded by a court on an appeal under the Income Tax Act (Canada) and under The Corporations Tax Act. The corresponding section of the Income Tax Act (Canada)—Section 6 (1) (q)—refers only to the legal costs awarded on an appeal in relation to a federal tax assessment.

(19) Section 18 (2) of The Corporations Tax Act provides that the discount on certain obligations will be included in computing the income of a corporation if it is the first owner of the obligation, has a permanent establishment in Canada and is not exempt from corporation income tax. Section 7 (2), the corresponding provision in the Income Tax Act (Canada), provides that such an amount will be included in the income of the first owner of the obligation who is resident in Canada and is not exempt from tax. This may be a different taxpayer from the corporation in whose income the amount is included under Section 18 (2) of The Corporations Tax Act.

(20) Section 10 (1) (a) of the Income Tax Act (Canada) provides a statutory exemption for amounts declared to be exempt from tax by any other legislation of the Parliament of Canada. Section 21 of The Corporations Tax Act provides no such blanket exemption.

(21) Section 21 (b) of The Corporations Tax Act provides for the exemption of income of a non-resident corporation earned from the operation of a ship or aircraft. This exemption applies only if the country where the corporation resides or maintains its chief place of business grants substantially similar relief to a corporation that resides or has its chief place of business in Canada. Section 10 (1) (c) of the Income Tax Act (Canada) contains a different condition, relating only to the residence of a corporation and not its chief place of business.

(22) Section 20 and Section 22 (8) of The Corporations Tax Act, which relate to banks, correspond with Sections 9 and 11 (4) respectively of the Income Tax Act (Canada). Both provisions of the Income Tax Act (Canada) and Section 22 (8) of The Corporations Tax Act refer to a bank to which the Bank Act or the Quebec Savings Banks Act applies. Section 20 of The Corporations Tax Act applies to any bank, the term *bank* being defined in Section 1 (1) 4.

(23) Section 22 (1) (t) of The Corporations Tax Act permits the deduction of expenses incurred in objecting to or appealing from a federal or Ontario corporate tax assessment. The corresponding deduction under Section 11 (1) (w) of the Income Tax Act (Canada) limits the deduction to expenses incurred in respect of objections and appeals against federal tax assessments.

(24) Section 22 (12) of The Corporations Tax Act provides for the deduction from income of all corporation taxes as defined in Section 22 (13) and the Regulations. The Income Tax Act (Canada) does not provide specifically for the deduction of corporation taxes. The provision in Section 12 (4) of that Act that no deduction shall be made in respect of corporation taxes except to the extent set out in that provision was substantially to the same effect, but that subsection was applicable only to the fiscal years 1957-61 and has not been renewed. It is understood to be the current practice of the federal Income Tax Department to allow deductions similar to those allowed under The Corporations Tax Act.

(25) Section 23 (1) (i) of The Corporations Tax Act provides for the disallowance of "a management or administration fee or charge" to the extent that the payment attracts the non-resident withholding tax under Section 106 (1) (a) of the Income Tax Act (Canada). The Income Tax Act (Canada) does not contain a similar provision.

(26) Section 25 of The Corporations Tax Act provides that the property described in each inventory shall be valued at its cost or its fair market value, whichever is lower, unless all the property described in all the inventories of the business is valued at cost or at the fair market value thereof. This section does not grant to the corporation a positive right to value its inventories at straight cost or at straight market. It indicates in a negative way that this may be done. On the other hand, Section 14 (2) of the Income Tax Act (Canada) and section 1801 of the Income Tax Regulations (Canada), specifically provide that inventories may be valued at straight cost or at straight market.

(27) Section 1802 of the Income Tax Regulations (Canada) provides in a detailed manner for the valuation of animals included in an inventory. Ontario does not have such a provision either in The Corporations Tax Act or in the Regulations passed thereunder.

(28) Section 29 of The Corporations Tax Act provides that in certain circumstances a corporation resident in Canada that has loaned money to a nonresident will be deemed to have received interest. The corresponding provision of the Income Tax Act (Canada) is Section 19. Subsection (2) of that provision provides that the section is not applicable if a tax has been paid on the amount of

the loan under Part III of the Income Tax Act. Section 29 of The Corporations Tax Act does not contain such an exception. Accordingly, a corporation may have such interest included in its income for purposes of Ontario corporation income tax but not for purposes of the Income Tax Act (Canada).

(29) Sections 32 and 33 of The Corporations Tax Act are analagous to the provisions of the Canadian Vessel Construction Assistance Act (Canada).* There are a number of differences, which may be summarized as follows:

(a) Section 3 (1) of the Canadian Vessel Construction Assistance Act provides that in certain circumstances a taxpayer *may* deduct an amount in lieu of a deduction under Section 11 (1) (a) of the Income Tax Act (Canada). Section 32 (1) of The Corporations Tax Act provides that in those circumstances a corporation *shall* deduct the amount it elected to take and was allowed under the Canadian Vessel Construction Assistance Act in lieu of a deduction under Section 22 (2) (a) of The Corporations Tax Act. On a literal interpretation this provision would not permit a corporation to claim any deduction under The Corporations Tax Act if it claims a deduction under Section 11 (1) (a) of the Income Tax Act (Canada) rather than under the Canadian Vessel Construction Assistance Act.

(b) Subsections (1) and (2) of Section 33 of The Corporations Tax Act are substantially different from the corresponding provisions in the Canadian Vessel Construction Assistance Act, namely subsections (1) to (1c) inclusive of Section 4 of that Act. Some of the latter provisions are omitted from The Corporations Tax Act.

(c) The Corporations Tax Act does not contain a provision comparable to Section 20 (9) of the Income Tax Act (Canada). Accordingly there is a possibility of a conflict between the provisions of Section 31 (8) of The Corporations Tax Act which provides that in certain circumstances a corporation engaged in fishing will not be subject to recapture of depreciation under Section 31 (1) and Section 33 of that Act which provides that an amount will be subject to recapture under Section 31 (1).

(30) Section 5 of the Coal Production Assistance Act (Canada) is applicable for the purpose of determining the income of a coal producer under the Income Tax Act (Canada). There is no corresponding provision in The Corporations Tax Act.

(31) The wording of Section 36 (1) of The Corporations Tax Act relating to bond conversion differs from the wording of Section 24A, the corresponding provision of the Income Tax Act (Canada). While there does not appear to be any significant difference in intent there are possible differences in interpretation of the words, particularly in paragraph (a) where the Ontario provision omits the words "was issued" which appear in the federal provision.

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*This Act was repealed as of March 23, 1967. Its main provisions are now incorporated in the Income Tax Act (Canada).

(32) Gifts made by a corporation to the Province of Ontario are deductible under Section 39 (1) 2 of The Corporations Tax Act without limitation, whereas such gifts are deductible under the Income Tax Act (Canada) only under Section 27 (1) (a), which limits the aggregate deduction of gifts to provinces, municipalities and charitable and certain other organizations to 10 per cent of income.

(33) Section 40 (1) of The Corporations Tax Act, which provides for the deduction of inter-corporate dividends, relates to dividends which a corporation has received "or is deemed by section 54 to have received". It does not specifically refer to dividends which are deemed by Section 19 to have been received. Section 28 (1) of the Income Tax Act (Canada) does not specifically refer to deemed dividends of any kind. The reference to Section 54 in Section 40 (1) of The Corporations Tax Act seems unnecessary and might be considered by implication to result in the exclusion of dividends deemed to be received under Section 19.

(34) Section 41 of The Corporations Tax Act provides for determining the taxable income of a life insurance corporation and is comparable to Section 30 of the Income Tax Act (Canada). Paragraph (c) of Section 41 of The Corporations Tax Act provides for the deduction of certain dividends which would be deductible under Section 40 (1) but does not permit the deduction of dividends which would be deductible under Section 40 (1a). Such dividends are deductible under paragraph (c) of Section 30 of the Income Tax Act (Canada).

(35) Section 42 (2) of The Corporations Tax Act defines a personal corporation. One of the requirements is that the corporation be controlled by an individual resident in Ontario, by such an individual and one or more members of his family who are resident in Canada or by any other person on his or their behalf. Accordingly a corporation controlled by an individual resident in a province other than Ontario may be a personal corporation under the Income Tax Act (Canada) but would not be a personal corporation under The Corporations Tax Act.

(36) Section 47 (2) of The Corporations Tax Act provides that the determination of whether any particular activity constitutes scientific research will be the same as the determination of the Minister of National Revenue under Section 72 (2) of the Income Tax Act (Canada). The latter provision permits the Minister of National Revenue to obtain certain advice but does not give him any power to determine whether a particular activity constitutes scientific research.

(37) Subsections (3) and (6) of Section 48 of The Corporations Tax Act relating to co-operatives are only applicable to a corporation that complies with all the conditions contained in paragraphs (a) to (e) inclusive of subsection (5) of that section. Subsections (2) and (3) of Section 73 of the Income Tax Act (Canada), which are the corresponding provisions, are applicable to co-operative corporations which do not necessarily comply with those requirements.

(38) Section 75 of the Income Tax Act (Canada) relates to patronage dividends paid by co-operative corporations. Subsection (4) (b) of that section provides that, subject to one exception, "capital employed in the business" shall be computed in accordance with the provisions of the First Schedule to The Excess

Profits Tax Act, 1940. Section 50 of The Corporations Tax Act which relates to patronage dividends does not refer to The Excess Profits Tax Act, 1940, but provides in subsections (8) to (13) inclusive for the determination of the "capital employed in the business". This definition is similar to that contained in the First Schedule to The Excess Profits Tax Act, 1940 but differs in some particulars. For example, subsection (8)1 refers to assets acquired by purchase on or after the incorporation of the corporation, whereas the First Schedule to The Excess Profits Tax Act, 1940 refers in paragraph 2(a) to assets acquired by purchase on or after the commencement of the business.

(39) Section 53a of The Corporations Tax Act relating to deferred profit-sharing plans differs in some particulars from Section 79C of the Income Tax Act (Canada). For example, the definition of *profit-sharing plan* contained in subsection (1)(b) refers to payments computed by reference to profits from the business of a "person" (which includes an individual) with whom the corporation does not deal at arm's length, whereas in the federal provision the reference is to the business of a "corporation" with whom the taxpayer does not deal at arm's length.

(40) Section 54 of The Corporations Tax Act, which relates to dividends deemed to have been received by shareholders, is comparable to Section 81 of the Income Tax Act (Canada). However, it does not contain a provision comparable to Section 81 (4) of the federal Act which reduces the amount included in computing the taxpayer's income where the payer corporation has tax-paid undistributed income. This might result in a deemed dividend being subject to corporation income tax in Ontario, but not under the Income Tax Act (Canada), where it is deemed to have been received from an exempt corporation such as a personal corporation or a foreign business corporation which has tax-paid undistributed income under the federal statute. It may be observed that The Corporations Tax Act does not contain a provision such as Section 82 (6) of the Income Tax Act (Canada), providing for determining the tax-paid undistributed income of a personal corporation (or any other provision relating to tax-paid undistributed income) but does provide in section 55 (9) for determining the undistributed income on hand of a personal corporation.

(41) The definition of undistributed income on hand contained in Section 55 (1) of The Corporations Tax Act differs in some respects from the corresponding definition contained in section 82 (1) (a) of the Income Tax Act (Canada). The differences include the following:

(a) While a corporation may deduct the excess of capital losses over capital gains made before the 1950 taxation year and the similar excess realized after the 1949 taxation year under sub-paragraphs (iii) and (iv) of the federal provision, only the excess of capital losses over capital gains whenever incurred is deductible under sub-paragraph 3 of the Ontario provision. This may be a substantially lower amount if the capital gains exceed the capital losses in one period and the capital losses exceed the capital gains in the other.

(b) Amounts that are deductible under sub-paragraphs (iva) and (v) of section 82 (1) (a) of the Income Tax Act (Canada) are not deductible under Section 55 (1) of The Corporations Tax Act.

(c) A dividend which is not deductible under sub-paragraph (vii) (B) of the federal provision is apparently deductible under the Ontario provision.

(d) Premiums paid on the redemption or acquisition of shares other than common shares are deductible under paragraph 6 of the Ontario provision whenever incurred but are deductible under paragraph (viii) of the federal provision only if paid on or after February 20, 1953.

(42) Section 57 of The Corporations Tax Act refers in subsections (1), (2), (3), (3b), (7), (8) and (10a) to deductions allowed under subsection (1) of Section 40 in respect of inter-corporate dividends. The corresponding provisions of Section 83A of the Income Tax Act (Canada) refer to deductions under Section 28 of that Act. This will create a different result for a corporation that is entitled to a deduction in respect of inter-corporate dividends under subsection (1a) of Section 40 of The Corporations Tax Act and Section 28 (10) of the Income Tax Act (Canada). Such dividends are not deducted in computing the amount deductible under Section 57 of The Corporations Tax Act but are deducted in computing the comparable amount under Section 83A of the Income Tax Act (Canada).

(43) Subsections (4) and (4a) of Section 83A of the Income Tax Act (Canada) are applicable to permit deductions in computing the income of a taxpayer from the business of an association, partnership or syndicate. There are no corresponding provisions in Section 57 of The Corporations Tax Act. This could possibly have an adverse effect on a corporation that is a member of an association, partnership or syndicate.

(44) There are several technical errors in Section 57 of The Corporations Tax Act as follows:

(a) In paragraph (f) of subsection (3b) the words in the last six lines, commencing with the words "as were incurred after the 10th day of April, 1962", should be taken out of sub-paragraph (ii) and moved out to the margin;

(b) The reference in subsection (5) to subsection (4) should be a reference to subsection (4a); and

(c) In subsection (10a) the words in the last seven lines commencing "and, in respect of" should be set out to the margin in a new paragraph.

(45) Subsection (2) (a) of section 85 I of the Income Tax Act (Canada) provides that the corporate entity formed as a result of an amalgamation shall be deemed to be a new corporation. Section 65 (2) 1 of The Corporations Tax Act does not so provide, and it is possible that by virtue of Section 96 of The Corporations Act the corporate entity formed as a result of the amalgamation is not a new

corporation but is a continuation of the predecessor corporations. This difference could have significant consequences in determining the taxable income of a corporation resulting from an amalgamation.

(46) The reference in the last line but four of Section 65 (3) of The Corporations Tax Act to paragraph 1 of subsection (2) should be a reference to paragraph 9 of subsection (2).

(47) The deduction from income in respect of mining taxes is determined under Regulations for both The Corporations Tax Act and the Income Tax Act (Canada). The amount of this deduction depends in part upon the amount of "income derived from mining operations". The definition of this expression in section 301 (b) of the Corporations Tax Regulations differs considerably from the corresponding definition contained in section 701 (2) of the Income Tax Regulations (Canada).

(48) Section 1300 of the Income Tax Regulations (Canada) permits a depletion deduction in respect of dividends received at the rate of 10, 15 or 20 per cent, depending on the proportion that the mineral profits of the corporation paying the dividend are of its total income. Section 501 of the Corporations Tax Regulations permits a flat deduction equal to 15 per cent of the dividend in cases where the deduction under the federal regulations would be 15 or 20 per cent. In circumstances where the deduction under the federal regulations would be 10 per cent no deduction in respect of the dividend is allowed under the Corporations Tax Regulations.

(49) Section 2700 of the Income Tax Regulations (Canada) set out the method of determining the amount deductible in respect of an employer's contributions to a registered pension fund or plan. The Corporations Tax Regulations do not contain a corresponding provision, although such a regulation would be necessary under subsection 22 (1) (j) (ii) of The Corporations Tax Act in order to ensure consistency of treatment between the two statutes.

Chapter 28

The Taxation of Wealth: Death and Gift Taxes

INTRODUCTION

1. This chapter deals with the taxation of wealth. Nearly all tax systems include some levies based in whole or in part on the ownership or transfer of wealth. Though these levies vary greatly in detail and impact, they can be grouped in four broad categories: net wealth taxes, gift taxes, death taxes and property taxes. Of these categories, the revenue system of Ontario uses only a death tax known as the Ontario Succession Duty, a real property tax on real estate in unorganized territories called the Provincial Land Tax, and the general real property tax at the municipal level. Only the first of these is examined in this chapter, the others being dealt with at some length elsewhere.

2. The strongest argument for taxing the possession, augmentation in value, or transfer of capital assets is that, combined with income and consumption taxes, such taxes enhance the equity of the whole system by making it conform better to the principle of ability to pay. At present our concept of income is interpreted in such a way that some forms of increases in wealth and economic well-being are not taken into account in determining tax liability. Capital gains, for example, are distinguished from income, thus avoiding the income tax, and they are not

subject to any other kind of tax. A man who invests in corporate shares or government bonds must include in his taxable income the dividends or interest that flow from his investment. On the other hand, cars, furniture, works of art, cottages, and stockings crammed with cash are all forms of wealth that do not produce money income, although they may all benefit their owners through use, prestige, or the sheer enjoyment of ownership. Holding wealth in these forms may not increase the income tax liability of the owners, but it certainly does affect their economic well-being. To the extent that the income tax ignores capacity to pay, as represented by ownership of capital assets, the whole revenue system departs from the principle of ability to pay. Taxes based on wealth can mitigate this deficiency and increase the general equity of the tax system.

3. Wealth taxes cannot be justified in any form at the provincial level by any strict interpretation of the principle of benefits received. Yet there is considerable merit in the point of view that holds that the private accumulation and maintenance of wealth are made possible in good part by the actions of government in creating and protecting the economic and social structure within which such assets are amassed. This contribution by government is surely of greater value than the cost of providing the services paid for through taxes. It can be argued that the State, as a silent partner in the accumulation of private fortunes, properly should share on behalf of all citizens in the prosperity of its more affluent members.

4. Those opposed to taxation of wealth have argued that the present succession duties in Ontario, together with the federal estate tax, tend to drive our citizens out of the province and to discourage both immigration and capital investment from abroad. Furthermore, they argue that such taxes encourage the transfer of native industry and resources to foreigners, since they decrease the amount of Canadian capital available for investment. Our highly progressive tax system, inspired by the example of economically more mature nations such as the United States and the United Kingdom, has increased the difficulty of generating within the country sufficient capital for our own needs. Income tax certainly reduces the rate of private capital accumulation, and death taxes disperse the accumulations that have already been made. Since the strength and growth—and indeed, the very foundations—of our economic system depend upon the willingness and ability of private citizens to accumulate and invest capital, these consequences are held to be anathema. On the other hand, a democratic society such as ours, espousing political equality for all its citizens, cannot permit undue concentration of wealth in the hands of a few. Though differences in wealth will always be with us, extremes of affluence and poverty must be prevented in the interests of a stable society. While other arguments may have been added in the theoretical support of equalitarianism, there is a continuing validity to Plato's warning that the State should avoid riches and poverty—"for the one produces luxury and idleness and revolution, the other revolution and meanness and villainy besides."[1] A reasonable tax on wealth is one way of ensuring a proper balance between these two objectives; capital accumulation and control of extremes of wealth.

[1]Plato: *The Republic*, Everyman's Library, London: J. M. Dent and Sons, 1935, p. 106.

5. We turn now to consider the particular form of wealth tax best suited to Ontario. As we have already indicated, there are several alternatives and combinations from which to choose.

TYPES OF WEALTH TAXES

ANNUAL NET WEALTH TAX

6. An annual net wealth tax is the form of annual tax that most closely relates to wealth. Some European countries now levy such a tax as an adjunct to income tax, although neither the rate of tax nor its yield is great. If an annual net wealth tax is to be justified by the principle of taxing on the basis of ability to pay, it should take into account all the financial circumstances of the taxpayer, including his assets throughout the world, his debts and his responsibilities to his dependants. Such a levy would require the annual discovery and valuation of the net wealth of every taxpayer. The enormity of this task can be judged by the difficulty the Succession Duty Branch now has in performing this feat as a one-time operation for the estates of those deceased persons whose representatives file succession duty returns. Another difficulty would arise in the treatment of corporate assets, since it would be desirable to avoid taxing their value twice, first in the hands of the corporation and again to the extent that they are reflected in the values of the shares and securities held by investors.

7. A net wealth tax would certainly provide a method of taxing those who hold valuable assets in forms that produce little or no money income. To the extent that the tax takes accrued gains and losses into account, it is more equitable than a capital gains tax, when that tax is based upon realizations. If it were imposed in place of death duties, it would have the advantage of occurring at regular intervals rather than unpredictably and capriciously at the time of death of the taxpayer. A net wealth tax would thus eliminate the concern of the very wealthy family to accumulate the funds needed to pay death duties at some indefinite future time.

8. On the other hand, it can be argued that a net wealth tax may tax capital at those times when an owner's needs are greatest for individual, family or business reasons, rather than at the end of his life when it is more likely that his family will be independent and his business in other hands.

9. Although it need not be so, a tax on net wealth may turn out to be no more than another tax on income. If the levy is annual, there will be a reluctance to impose it at a rate which, when added to the income tax, amounts to more than total income. In fact, in Sweden, Denmark and Germany, where the tax is now used, it is so related to the income tax that the combined levies cannot exceed a fixed proportion of income. Viewed in this way, the tax is not a substitute for death duties, as it does not prevent undue accumulations of wealth from passing from generation to generation.

10. Studies we have undertaken indicate that the complexities of administering this tax are much greater than for death taxes or even capital gains taxes and that

a net wealth tax would be particularly difficult for a single province to adopt. We conclude, therefore, that a net wealth tax is not appropriate for Ontario.

GIFT TAX

11. *Inter vivos* gifts (gifts made during a taxpayer's lifetime rather than at death) made by individuals and personal corporations are taxed under a special provision of the federal Income Tax Act. The object of that levy is to impose a form of penalty tax on a taxpayer who makes gifts in excess of certain limits, as in some circumstances the donee's income tax on the income derived from the gifted property may be less than the donor's would have been had he not made the gift. Viewed merely as an income tax imposing varying flat rates depending on the size of the gift, the present provisions permit significant avoidance of the death taxes that are imposed by both Canada and Ontario. We hold the opinion that gift taxation should be complementary to death taxes as well as to income taxes. Later in the chapter we shall consider this tax at length.

ACCESSION TAXES

12. An accessions tax is essentially a combined inheritance and gift tax. A form of accessions tax was adopted by Japan in 1950 in keeping with a recommendation made by the Shoup Mission, a committee of experts under the chairmanship of Professor Carl Shoup of Columbia University. In 1953 the tax was withdrawn because of administrative difficulties and it has not been reintroduced. A description of the tax is given in the Shoup Report as follows:

> The Accessions Tax is a cumulative tax on the recipient of gifts and bequests. The tax is graduated progressively according to the total amount of gifts and bequests received by a given individual. The manner of its application is similar to that of the Gift Tax; when a gift or bequest is received, it is added to the total of taxable gifts and bequests previously received, and a tax is computed on this total according to the current set of rates. A tax is also computed at the current set of rates on the previous cumulative total, and the difference between the two taxes is the tax currently due.

13. The chief argument put forward in support of this tax is that it comes closer to taxing on the basis of ability to pay than does any type of death tax alone. It is claimed that an individual's ability to pay increases as subsequent gifts and bequests are received, so that a higher rate of tax can equitably be applied to later increments than to earlier ones. And it is maintained that ability to pay must pertain to the beneficiaries, since it is nonsense to say that an impersonal estate or a dead person can have ability to pay. We see three flaws in this line of reasoning.

14. In the first place it is by no means certain that periodic accretions of wealth to individuals are kept to make permanent additions to their economic well-being. At the time of inheritance, a man's capacity to pay tax may be no greater because of a gift he received a few years previously than if he had never received such a gift. In the interim he may have spent it, given it away or lost it through bad investments. We should not assume, for the purposes of taxation, that all

citizens are able or even willing to retain whatever capital comes fortuitously into their hands by gift or inheritance during their lifetime. In brief, the tax bears no certain relationship to ability to pay at the time of taxation.

15. Second, the concept of ability to pay must take into account the personal circumstances of taxpayers. An accessions tax, as proposed, does not differentiate between a profligate playboy and a widow with children to educate, nor does it take into account the wealth of the recipient. A single rate schedule is applied to all recipients regardless of the responsibilities and the existing wealth they have accumulated from their own efforts. Presumably, by adding such complexities as differential rate schedules or exemptions based on personal circumstances, an accessions tax could be made to correspond more closely to ability to pay than the tax as proposed. Such features would, however, destroy the essential simplicity of the tax, and the tax consequences would differ according to the timing of the accessions.

16. Finally, we do not agree with the views of the proponents of this tax on the question of its incidence. The accessions tax is supported on the assumption that it is the recipient who must bear the burden of any taxes paid on gifts and bequests. We know, however, that this assumption is not universally true and there is some doubt of its general validity. As we point out in a later section, the deceased is frequently the one who has borne the burden of death taxes. Thus we question the foundation on which the whole justification for an accessions tax is built.

17. In addition to these considerations of equity, there are administrative difficulties in an accessions tax that are not present in a death tax. One of the least attractive features of the tax is that it requires the maintenance of open files on citizens for long periods of time, possibly throughout their entire lives. Any advantages the tax might have would be lost unless it were absolutely certain that all gifts and bequests would be taken into account each time tax is calculated; this might be impossible for new residents who had received bequests before moving to Ontario. For all these reasons, we reject the accessions tax as being inferior to other forms of levies on wealth.

DEATH TAXES

18. The final form of wealth tax to be considered is the death tax. The two major forms of such levies are succession duties, which are levied on beneficiaries. and estate taxes, which are levied on the estates of persons who die. The differences between these types of tax are essentially technical; their impact is similar. Hence the justification for a succession duty will be the same as that for an estate tax, and the two will be considered together in this section.

19. All the arguments put forward for wealth taxes can be applied to death taxes. The possession of wealth denotes a capacity to pay taxes. By assessing tax on all assets, the levy will draw on those accretions to wealth that have not been taxed

directly during the lifetime of the deceased as well as on savings from income that have been taxed. Death taxes, then, may be thought of as end-of-the-road taxes through which government, on behalf of all the people, exacts its final contribution from citizens who have prospered in the economic and social environment that the government has helped to maintain. Ownership of wealth implies both capacity and a responsibility to pay taxes. This capacity grows apace as assets are accumulated during a lifetime. Thus there is what may be regarded as a contingent liability for tax which accrues during one's lifetime as one's wealth increases. This liability, growing in accordance with ability to pay, crystallizes at the date of death.

20. A death tax, more than any of the other levies on wealth, can be made to relate closely to notions of equity and ability to pay. In the first place, there is less likelihood that the existence of some assets will not be known or disclosed. The base is thus more certain than for a net wealth tax or an accessions tax. Second, this tax makes allowances for the particular financial responsibilities of the taxpayer at his death, a most crucial time for the welfare of his family. The provisions of a will give an indication of what the testator thought his responsibilities to be. Through rate schedules or exemption provisions, the tax can be designed to allow some tax-free transmission of assets to dependants, and hence made to conform to the principle of taxing on the basis of ability to pay.

21. Some writers have justified death taxes on the grounds that many inheritances not only enhance the recipient's ability to pay but are in fact windfalls to the beneficiaries. They claim that once widows and other dependants are looked after by suitable exemptions, all bequests can be taxed similarly in the name of equity. This argument maintains that inheritance is, after all, a fortuitous way of getting rich, and that government has a right to share in the good fortune of the heirs. We do not accept this as an appropriate argument in support of death taxes. Very few testators leave substantial amounts to people who have not shared in their lives. Wills are drawn up to distribute assets to those who deserve, for whatever reason, the patronage of the testator. Inheritances of any size are usually windfalls only in the sense of the uncertainty as to their actual amount and the time of the transfer.

22. Death taxes, if adequately protected by gift taxes, are admirably suited to control the growth in this country of an economically powerful minority whose influence is based upon inherited wealth. By this device, the amount of capital that passes from one generation to another can be controlled, an essential safeguard for the basic fabric of a democratic society. Moreover, because the tax is not payable until death, this end is achieved with a minimum deterrent to working and saving during a man's earning and creative life. We realize, however, that the objective of limiting undue accumulations of wealth can be defeated by sophisticated tax planning.

23. From the foregoing discussion of the various forms of wealth taxes, we conclude that Ontario should impose a tax on wealth, and that this tax should take the form of a death tax.

CHARACTERISTICS OF DEATH TAXES

WHO PAYS DEATH TAXES

24. We recognize the great divergence of opinions among economists and others as to the incidence of death taxes. Four different answers have been given. The first, and least credible, was given by Jeremy Bentham, who said that there would be no burden even if the tax took the whole of the estate. If there were no expectation of inheritance on the part of otherwise prospective beneficiaries, there would be no burden on them if estates were entirely escheated to the Crown.

25. A second point of view suggests that the beneficiaries bear the whole burden of the tax, especially if the tax is of the inheritance type. If all else is uncertain, one thing is sure: the tax does reduce the amount of the estate received by its beneficiaries. Thus, runs the argument, since the inheritances are less than they would have been without the tax, it must be the beneficiaries who bear the burden. It would be difficult to deny the validity of this point of view in this very restricted sense. It may be, however that in the absence of death duties the State would resort to other means such as net wealth taxes, higher income tax rates, or capital gains taxes to reduce the size of accumulated fortunes during a taxpayer's lifetime.

26. The third contention is that death taxes are borne by the deceased. It is suggested that individuals organize their affairs during their lifetime to provide for the taxes payable at their death. It is certainly true that a very large proportion of estates contain enough liquid assets to meet these levies. Although we have no exact measure of the distribution of liquid assets in particular estates, it is evident from our study[2] that providing for liquidity is a major consideration in the construction of most. Tables 28:1 and 28:2 illustrate respectively the relationship between liquidity and the age of the deceased and between liquidity and the size of the estate. One would expect that both with increasing age and increasing wealth, the need to provide liquidity against death duties would increase. Our figures suggest that the proportion of liquid assets held does in fact increase to some extent in relation to these factors.

27. Table 28:1 indicates that the most pronounced shift with age in asset-holding proclivities is a gradual decrease in the importance of life insurance and a more than compensating increase in the importance of bonds and shares. This substitution does not represent a significant drop in asset liquidity. Hence, we can say that there is a tendency on the part of older citizens to increase the proportion of their estates held in liquid form. The relationship between estate size and liquidity shows a general tendency for liquidity to vary directly with the size of the estate, as shown in Table 28:2. From these figures we conclude that there is an observable tendency for older and richer people to hold a larger proportion

[2]With the assistance of the Ontario Treasury Department and the Department of Economics and Development, this Committee undertook a study of the estates handled by the Succession Duty Branch during 1963. Interested readers are referred to this study, which will be published subsequent to this Report.

TABLE 28:1

PROPORTION OF NET VALUE OF ONTARIO TAXABLE ESTATES REPRESENTED BY LIQUID ASSETS, 1963 BY AGE OF DECEASED

Asset	Age of deceased											
	21-30	31-40	41-50	51-55	56-60	61-65	66-70	71-75	76-80	81-85	over 85	All estates
	%	%	%	%	%	%	%	%	%	%	%	%
Cash	17.9	9.0	8.1	6.2	12.5	9.6	10.9	13.4	12.3	11.3	12.3	11.5
Lump-sum life insurance	43.4	33.0	29.5	23.9	17.0	12.7	7.3	4.8	3.6	3.6	1.5	7.3
Government of Canada and provincial bonds	1.0	1.5	4.1	5.9	5.6	12.9	11.1	17.9	17.5	14.4	20.3	14.3
Other bonds and listed stocks	2.2	11.1	10.1	17.3	19.2	23.8	25.6	29.8	34.9	41.0	40.5	31.9
Liquid assets	64.5	54.6	51.8	53.3	54.3	59.0	54.9	65.9	68.3	70.3	74.6	65.0

Source: Ontario, Treasury Department.

TABLE 28:2

PROPORTION OF NET VALUE OF ONTARIO TAXABLE ESTATES REPRESENTED BY LIQUID ASSETS, 1963 BY SIZE OF ESTATE

	0 to $99,999	$100,000 to $499,999	$500,000 to $999,999	$1,000,000 and over	All estates
	%	%	%	%	%
Cash	16.8	8.6	9.6	7.9	11.5
Lump-sum life insurance	9.2	8.6	3.2	1.9	7.3
Government of Canada and provincial bonds	13.6	11.9	15.8	21.5	14.3
Other bonds and listed stocks	19.1	34.1	41.0	50.1	31.9
Liquid assets	58.7	63.2	69.6	81.4	65.0

Source: Ontario Treasury Department.

of their assets in liquid form. It is clear, however, from the changes in the proportion of such assets as life insurance and cash that other factors besides death taxes account for the liquidity of estates as a whole.

28. To the extent that this liquidity is deliberately achieved or maintained with death taxes in mind, the behaviour of testators must have been affected by the duties. Those who wish to pass certain assets intact to their heirs, or more generally want to leave an estate of a certain size unencumbered for distribution, must allow for the eventual duties in the handling of their affairs throughout their lives. To achieve this objective, people must necessarily make some decisions differently than they otherwise might have. They may, for example, buy more insurance, increase savings rather than expenditures, or alter investment decisions. In addition, Canadian tax practitioners are aware of the lengths to which some individuals will go to minimize the tax payable at death, including pulling up their stakes and moving to tax-free Caribbean islands where they can also avoid income taxes. For these reasons it may be argued that it is the testators who bear the burden of the tax on their estates.

29. The fourth answer to the question of incidence observed by some economists is that the tax is borne in part by the deceased and in part by the beneficiaries. It is quite true that some people provide for death taxes during their lifetimes. On the other hand, there are undoubtedly many individuals, perhaps adopting the philosophy of the grasshopper rather than the ant, who make no such provision at all. This leads to the conclusion that the tax generally is borne in some degree by both testators and successors, and that while it may be possible to attribute the burden to one or the other in specific cases, no general allocation of incidence can be made.

30. We are impressed with the arguments and evidence supporting the view that many people, by arranging their affairs with the tax in mind, bear the principal burden, at least in the first instance. Because testators can through their action—or indeed often their deliberate inaction—determine how the duties shall be paid and how the assets of the estates will be distributed, it is they who are primarily responsible for providing for the levy. The accumulation and preservation of an estate is achieved by the positive efforts and self-restraint of a testator during his lifetime; spending and giving must be curtailed to the extent that assets are accumulated and maintained. What is true of an estate as a whole is also true of that part which is eventually paid in death taxes, whether the deceased made any specific provision for these taxes during his lifetime or not. Successors receive only what it pleases the testator to leave them after all taxes have been paid, and we cannot assume that the size of bequests is determined without consideration for the duty. For these reasons, we conclude that the burden of succession duties or estate taxes in the main falls on the deceased, the person who accumulated the assets from which the levy is paid. On the other hand, we know that it would be unrealistic to deny that some of the burden falls on the beneficiaries—

TABLE 28:3

DISTRIBUTION OF NET ASSETS, NUMBER OF ESTATES, AND SUCCESSION DUTY LIABILITIES OF DUTIABLE ONTARIO ESTATES CLASSIFIED ACCORDING TO SIZE [1963]

Net value of estate	Number of estates	Total net value	Succession duty liabilities	Percentages of total: Number of estates	Net value	Succession duty liabilities
		(thousands of dollars)		%	%	%
Less than $ 25,000	1,173	$ 18,312.3	$ 1,225.9	29.4	5.0	3.1
$ 25,000 - 99,999	1,943	110,853.0	7,796.3	48.8	30.3	19.6
100,000 - 199,999	554	74,817.8	6,888.9	13.9	20.5	17.4
200,000 - 499,999	235	70,316.6	8,418.1	5.9	19.3	21.2
500,000 - 999,999	51	35,715.6	5,364.7	1.3	9.8	13.5
1,000,000 and up	27	55,292.1	9,985.3	0.7	15.1	25.2
	3,983	$365,307.4	$39,679.2	100.0	100.0	100.0

Source: Ontario Treasury Department.

particularly the residual beneficiaries. We conclude, therefore, that while the long-term impact of death duties is to reduce the material resources of beneficiaries, the burden is borne in the first instance by testators.

31. Although the allocation of the burden between testators and beneficiaries may be hazardous, there is no difficulty in showing that the death duty is a tax on the rich, not the poor. The revenue derived from succession duties is of course related to the size of the estate left by the deceased. Because the rate structure is progressive, the very large estates, although few in number, pay a large proportion of the duties.

32. Table 28:3 outlines the distribution of the tax burden on estates of various sizes. The smallest dutiable estates, those under $25,000, constituted close to 30 per cent of the total number of estates, but they accounted for only 5 per cent of their aggregate value and they paid only 3 per cent of the total duties levied in 1963. At the other extreme, estates valued at more than $1,000,000 constituted only 0.7 per cent of the total number, yet they accounted for 15 per cent of the total net value and paid 25 per cent of the duties levied. A further indication of the weight of this tax on the larger estates is the fact that fewer than 1 in 12 of the dutiable estates processed in 1963 were valued at $200,000 or more, yet this group paid 60 per cent of the duties.

33. Lest there be any doubt about the progressivity of death duties as related to income, Table 28:4 shows the distribution of the size of dutiable estates by income ranges of testators. The evidence is clear that there is a positive correlation between income and size of estate. There is no doubt that death duties, which are imposed at progressive rates, weigh more heavily on the rich than the poor.

TABLE 28:4

MEAN SIZE OF DUTIABLE ONTARIO ESTATES
CLASSIFIED BY INCOME OF DECEASED [1963]

Income range	*Mean size of estate*	*Number of dutiable estates*
$	$	
1 - 999	34,200	67
1,000 - 1,999	39,200	320
2,000 - 2,999	50,500	480
3,000 - 3,999	60,000	409
4,000 - 4,999	72,700	293
1 - 4,999	54,100	1,569
5,000 - 5,999	81,600	224
6,000 - 7,999	101,400	254
8,000 - 9,999	125,600	145
5,000 - 9,999	99,900	623
10,000 - 14,999	168,000	209
15,000 - 19,999	223,500	113
20,000 - 29,999	312,300	61
30,000 - 99,999	942,600	56
100,000 - and up	4,449,700	4
Income not reported	50,600	1,348
All Estates	91,700	3,983

Source: Ontario Treasury Department.

ECONOMIC CONSEQUENCES OF DEATH TAXES

34. The obvious effect of levying death taxes is a reduction in the amount of private wealth that can be passed on at death from one generation to another and in the size of fortunes that could otherwise be maintained within families. It is impossible to say whether these taxes have actually brought about a lessening of gross inequalities of incomes within the country, since no Canadian study has been made. It is certain, however, that the rate of increase in the number of persons inheriting great wealth is reduced by our death taxes. This effect on the distribution of wealth may well be more important for its socio-political implications than for its economic consequences.

35. It is unlikely that succession duties themselves exert a great impact on savings. On the one hand, they will not encourage dis-saving (consumption out of past savings). It is a simple observation that few people would spend their fortunes, thereby effectively disinheriting their heirs, rather than allow a portion of what they otherwise could have passed on to go to the government in taxes. We believe that in these matters people are more strongly motivated by considerations of responsibility to their families and to succeeding generations than by any feelings generated by taxes. On the other hand, those who do not save are unaffected by death duties, since they leave nothing behind to tax. Those who save against a "rainy day", and those who forgo present consumption in the expectation of enjoying the benefits of greater income in the future, are not likely to have their propensities affected by this levy. Young people, we think, will continue to save and invest in accordance with their values no matter what tax may come due at some date in the distant future. Those fortunate few who save because they are incapable of spending all of their incomes are unlikely to be affected, although they, more than others, may be prompted by death tax considerations to give away some of their wealth.

36. Some persons, more aware than others of the taxes that their holding of assets will attract, begin a significant program of gifting during their lifetime to their prospective beneficiaries. Many others deliberately arrange their affairs to make provision for this future liability. If they want to pass on certain assets, or assets of a certain total value, they will increase their savings or insurance programs, or work harder to earn more to provide extra wealth, equal to the duty the assets will attract. For people such as these, the death tax provides a positive incentive to saving.

37. In summary, then, we think that the succession duty has little net effect on the general propensity to save, but in those cases in which it does influence behaviour, it is more likely to increase savings than to encourage spending.

38. There seems little reason to suppose that death taxes have much effect on the total accumulation of capital goods, especially when investment by government is taken into account. In the process of capital formation, the relative importance of the public sector may indeed increase, but this should by no means be thought of as necessarily undesirable. To the extent that the general tax base is broadened

by the use of death taxes, the immediate or annual burden on citizens of income and sales taxes is relieved, and investment in the public sector of the economy made less onerous on the productive workers in society.

39. We have been told that succession duties have a harmful effect on owners of private businesses. It is contended that the tax forces the sale of businesses, often at the most inconvenient and critical times, frequently resulting, it is alleged, in the expatriation of the ownership of Canadian concerns. We have also been told that elderly entrepreneurs do not respond to pressures to continue the expansion of their businesses because of the need for consolidation of, and the provision of liquidity in, their estates. We have been deeply concerned with these arguments, since we would seek to avoid any consequences of tax policy that prejudice Canadian ownership of business enterprises within an expanding economy. However, not only did no one present to us any conclusive examples of Canadian-owned businesses having been sold to foreign interests because of death duties, but our own researches were equally fruitless in bringing specific cases to light. In each instance of which we are aware, succession duties were at best a marginal consideration, not the motivating or deciding factor in the sale.

SUCCESSION DUTIES VS. ESTATE TAXES

40. Death taxes as used today take two general forms. The first, used by Ontario, Quebec and British Columbia, is a tax on beneficiaries on the amounts that they receive by way of inheritance; this is a succession duty or inheritance tax. The second, now imposed by the federal government, under the name of an estate tax, is a levy on the estate of the deceased, which extracts a share of the assets before they are distributed to beneficiaries. The difference, then, lies in the taxpayer. The estate tax assessor looks upon the body of the deceased and in effect says "alas, my poor brother". The succession duty assessor looks upon the assembled heirs, murmuring "fortunate children".

41. In its pure form the estate tax is much simpler and undoubtedly easier to administer than a succession duty. To arrive at the estate tax, all that is required is to determine the total assets and taxable dispositions, then to deduct debts, funeral expenses, certain court costs and exemptions, and finally to apply the appropriate rate to the remainder. The tax is then collected from the executors or administrators of the estate and the remaining balance is distributed to, or held for, the beneficiaries. A succession duty is more complex, since the tax must be determined and collected on the value of each inheritance. Furthermore, the rates of duty may vary with the relationship of the beneficiary to the deceased and the size of the estate, as well as with the size of the bequest, making the rate schedules voluminous and complex.

42. In practice, however, the difference between the two is not as great as appears in theory. Estate taxes in most jurisdictions take into account the relationship of beneficiaries to the decedent. For example, the federal Estate Tax Act provides exemptions if the deceased had a widow or dependent children, which

reduce the amount of tax that the estate would otherwise have to bear. Similarly, some succession duty Acts, such as the present Ontario statute, use the total value of the estate as one factor in determining the rate of tax.

43. Indeed, the distinction between the two forms is unlikely to be noticed by those who are legally liable for the tax. The Canadian Estate Tax Act requires the executors to pay the levy from the assets of the estate before distribution is made to the beneficiaries. The Ontario Succession Duty Act imposes the tax on the successors but prohibits executors from distributing inheritances without withholding the duty applicable to them. Any remaining differences are further diminished by the increasingly common practice of providing in wills that the executors shall pay all taxes out of the residue of the estate. Thus, although in theory the two forms of death tax are different, the effect on testators, beneficiaries and executors is on the whole quite similar.

44. There is one factor that greatly limits the freedom of a Canadian province in choosing between these two forms of tax. As has been mentioned in other chapters, the British North America Act imposes certain limitations on the methods that provincial governments may use to raise revenue. The constraint of direct taxation prohibits a province from imposing a levy that is demanded of one person in the expectation that he will recover the payment from someone else. Thus Ontario is prevented by constitutional considerations from levying a tax on the estate of a deceased person before distribution to beneficiaries. To be direct, the courts have said, a death tax must be levied on the heirs.

45. This does not mean that the total size of an estate cannot be taken into account in computing the amount of tax due. In fact, under the present Ontario Act the rates of tax imposed on a beneficiary are in part based on the aggregate net value of the estate and in part on the amount by which he benefits from the estate and his relationship to the deceased.

46. In summary, although there is considerable latitude allowed in determining the method of calculation of the death duty, the provincial tax must be demanded directly of those benefiting from a distribution of assets. Ontario must, therefore, levy a tax that takes the form of a succession duty.

THE PRESENT ONTARIO SUCCESSION DUTY

HISTORY

47. Ontario first levied a succession duty in 1892, and in doing so it initiated this form of taxation in Canada. By its action the Province adopted one of the oldest tax levies in history, one known to both the ancient states of Egypt and Rome. European countries have taxed property on the death of its owner for centuries. In 1797 the United States of America introduced an inheritance levy in the form of a stamp tax, similar to that in Great Britain, but public pressure soon forced its withdrawal. It was not until the Civil War brought with it greatly increased financial demands that a death tax was reintroduced by the United States government. Some type of death tax is now levied in all but a few western

countries, those few no doubt gaining certain compensating advantages from not doing so.

48. In 1892, soon after Ontario introduced its succession duty, New Brunswick, Nova Scotia and Quebec enacted similar legislation, and within the next two years Prince Edward Island, Manitoba and British Columbia followed suit. In 1903 a succession duty was imposed in the Northwest Territories, and was adopted by Saskatchewan and Alberta when they were accorded provincial status in 1905. It was not until 1941 that the Government of Canada passed its own death tax legislation, modelled after the provincial statutes. While its action was defended as necessary to raise war revenue, the Government announced that it was not to be a temporary measure. There has been no wavering from this intention. Although changed in form, the federal death tax is still with us.

49. In 1947 the governments of all provinces except Ontario and Quebec entered into a five-year agreement with the federal government to abandon their succession duties, in return for direct payments from the federal treasury. These agreements were renewed for further five-year periods in 1952, 1957 and 1962, the sole exception being British Columbia which reimposed its own succession duty in 1963. Also in that year the federal government agreed to remit 75 per cent of estate tax collections to the provinces with which it had an agreement, and to allow an additional abatement to estates in those provinces that increased their succession duty rates. Thus since British Columbia increased its succession duty rates, the abatement to a British Columbia estate is 75 per cent of the federal estate tax. On the other hand, as Ontario and Quebec have continued to levy succession duties without any increase in rates, Ottawa allows Ontario and Quebec estates an abatement of 50 per cent of its estate tax and pays to the Province one-half of the 50 per cent portion that it collects.

50. Recently the government of Alberta has enacted legislation to refund to the estates of domiciliaries and certain residents the portion of the federal estate tax which is paid over to that Province. Saskatchewan has indicated that it may take similar action. There has also been some agitation in Quebec to abandon the succession duty. In our opinion it would be improper for Ontario to repeal its death tax. For the reasons we have given, we consider the succession duty to be the most appropriate method of taxing wealth in the provincial tax system.

BRIEF DESCRIPTION

51. The present Ontario Succession Duty Act[3] is an extraordinarily complex piece of legislation. Although the Act was completely rewritten in 1939, it has been changed almost annually since that time. In fact, during the last fifteen years, the legislature has only twice failed to pass some amendment to the statute. This section will briefly outline how the present statute operates.

52. The first step in determining the tax liability under the Act is to calculate the "aggregate value" of the estate. To arrive at this figure, the value, less

[3]R. S. O. 1960, c. 386.

encumbrances, of all property passing on the death of the deceased must be determined. In addition to the assets that are clearly property passing through an estate under the common law, the statute deems certain other assets to be included, such as insurance proceeds, joint property passing by survivorship, and dispositions or gifts made during the lifetime of the deceased. From this total are subtracted the outstanding general debts of the deceased, funeral expenses, surrogate court fees and an arbitrary allowance of $100 for legal expenses. Other deductions include the gifts and bequests made to charitable organizations in Canada, all gifts made more than five years before death, certain small non-commutable annuities left to dependants, and gifts made to dependants for necessaries or education. The resulting amount is the "aggregate value" of the estate. This amount is used to determine the basic or initial rate of tax. The next step is to determine "dutiable value", which is the net value of property passing to each particular beneficiary.

53. The "aggregate value" includes all assets of the deceased, wherever situated in the world, without regard to the location of the beneficiary. However, Ontario can tax only property and people legally situate within its borders. Thus there are often some assets of estates which the Province cannot tax but whose value is included in the "aggregate value" used to determine the rates of duty. Once established, however, this initial rate of duty is levied on only the property and people that Ontario is empowered to tax.

54. Certain exemptions are allowed that permit property to pass free of tax. These include gifts to charity, amounts of $500 or less given to one person, and annuities not exceeding $100 per annum. The effect of not imposing rates of tax on property of less than certain amounts is to allow further exemptions. It is in this manner that all estates with an aggregate value of less than $10,000 escape duty.

55. At this stage, the rates of tax can be applied to the bequests, transmissions and dispositions received by each beneficiary. The rates are dependent on three factors: the aggregate value of the estate, the dutiable value of the benefits, and the relationship of the beneficiary to the deceased.

56. Three classes of beneficiaries are recognized: the *preferred* class, composed of members of the immediate family of the deceased; the *collateral* class, composed of certain more distant relatives of the deceased; and the *stranger* class, all beneficiaries not included in the other two categories. Two rate tables are used for the first two classes: the initial rate is dependent upon the aggregate value of the estate, and the additional rate varies with the "dutiable value" of the beneficiary's share. Rates are higher for collaterals than for the preferred class. For strangers only one rate applies, a rate calculated on the basis of the aggregate value alone. In all cases a surtax is payable on the duty calculated from the rate schedule. This surtax is at the rate of 15 per cent for preferred beneficiaries, 20 per cent for collaterals and 25 per cent for strangers.

57. This brief summary should give the reader a notion of the bewildering complexity of the tax and as it is now applied in Ontario. The actual statute that

dictates these intricacies is frequently so abstruse that it has gained almost universal notoriety among practitioners as being the worst piece of tax legislation on the books of the Province. One writer has called it unpardonable; certainly a thorough rewriting of the Act is long overdue. In succeeding sections of this chapter we will examine many of the provisions in detail and propose a new format for the tax that would considerably simplify the statute.

SUCCESSION DUTIES AS A SOURCE OF REVENUE FOR ONTARIO

58. The revenue derived from succession duties must necessarily be a function of the size of estates left by deceased persons. Because the rate structure is progressive, the very large estates, although few in number, pay a large proportion of total succession duties. Thus considerable fluctuations in the yield from this tax must be expected; the deaths of one or two extremely wealthy citizens can dramatically boost revenue in any fiscal period. These short-run variations are obviously unrelated to the general state of the economy at any one period of time. On the other hand, economic conditions can affect the death duty in both the short and the long run. Fluctuations of the stock market, and particularly of the magnitude that occur in major depressions and in periods of rapid expansion can influence the value of estates, and hence the yield of the tax. In the long run, too, the over-all prosperity of the country will be reflected in the size of estates. In summary, then, we can expect death tax yields to vary from year to year, but over long periods of time they should generally reflect economic trends.

59. In fact, the relative importance of the succession duty has been steadily declining in comparison with other Ontario revenue sources. For a few decades, the tax provided a relatively large proportion of provincial revenue. When it was first introduced, rates were low and exemptions high, with the result that at the turn of the century, succession duties represented only 5.4 per cent of the total cash receipts of the province. Amendments to the Act resulted in more revenue being produced, and by 1930 it accounted for nearly 20 per cent of Ontario's net ordinary income. Since the war, the tax has gradually diminished in importance until in the current year, fiscal 1966-67, it is expected to account for only 3.2 per cent of the Province's net ordinary revenue. While the relative importance of the succession duty has declined, the amount of revenue it has generated has gradually increased. This increase is the result of the general growth of wealth in the province, as well as changes in the Act that have increased the effective rate of tax.

60. Table 28:5 shows the growth of revenue from the Ontario succession duty, and its relative importance to the Province's total revenue.

THE TAX BASE FOR SUCCESSION DUTY

CONSTITUTIONAL LIMITATIONS

61. By Section 92(2) of the British North America Act, provincial governments are limited to "Direct Taxation within the Province in order to the raising of a Revenue for Provincial Purposes". The question of what is "within the Province" has, as might be imagined, given rise to a great deal of litigation. As a result,

TABLE 28:5

YIELD OF THE ONTARIO SUCCESSION DUTY FOR SELECTED YEARS

Fiscal year ending in	*Succession duty*	*Net ordinary revenue*	*Duty as percentage of revenue*
	(*thousands of dollars*)		%
1893[2]........	46	6,330	0.7
1900[2]........	227	4,192	5.4
1910[2]........	680	8,891	7.6
1920[2]........	3,892	25,078	15.5
1930.........	11,229	57,343	19.6
1940.........	11,500	88,173	13.0
1945.........	12,783	117,124	10.9
1950.........	14,978	228,550	6.6
1955.........	25,819	399,393	6.5
1960.........	33,736	702,470	4.8
1961.........	37,603	739,391	5.1
1962.........	40,397	825,352	4.9
1963.........	44,149	993,612	4.4
1964.........	44,121	1,079,136	4.1
1965.........	48,683[3]	1,237,244	3.9
1966.........	56,968[3]	1,442,845	3.9
1967[1]........	57,000[3]	1,779,358	3.2

Source: Ontario, Public Accounts.

[1]Estimated.

[2]For the years shown before 1919-20, the concept of net ordinary revenue was not used in the Public Accounts. The figures shown are the total cash receipts of the Province, except where allowance has been made for an obviously capital receipt.

[3]In addition, the Province received from the federal government 50% of the estate tax collected by it from Ontario estates in the years 1965 and 1966 as follows:

1965	$15,116,000
1966	16,837,500
1967	19,743,000 (est.)

certain rules have been established to determine under what circumstances Ontario may levy duty.

62. There appears to be no legal reason why Ontario could not tax anyone in Ontario with respect to property he receives from any source and situation, and anyone, no matter where he lives, with respect to property in Ontario. In fact the Province only taxes a beneficiary in Ontario if the deceased person had his domicile in the province, but taxes property in the province wherever the beneficiary may reside. This has been the common practice of taxing jurisdictions. The English common law pertaining to the situs of property and the domicile of persons is applied in Ontario.

63. We must turn to the law of domicile to answer the question of who are persons within the province. For a person who was born, lived his life and died in Ontario, there is no problem; he has a domicile of origin in the province. But a person who was born elsewhere has, under the common law, a domicile of origin in that other place. He may acquire an Ontario domicile of choice by taking up residence here *and* by intending to remain in Ontario indefinitely. However, a common occurrence is the American or British person living in the province who

expects to go "home" to retire or die, and therefore, although a resident, is not domiciled in Ontario. Similarly, a person born in Ontario who, like his American or British counterpart, lives abroad for many years may still be domiciled in Ontario. A domicile of choice is difficult to acquire and easy to lose. The domicile of origin is always but a few short steps behind the wanderer, ready to displace the domicile of choice upon the slightest excuse. In an age when the movement of people is swift and frequent, the law of domicile does not entirely suit current conditions. Since each province of Canada, like each state of the United States, is a domiciliary district, the possibility of uncertainty and conflict is immense.

64. It would seem to us that a person who could be thought to have economic allegiance to Ontario because he has lived here, worked here and accumulated an estate here, even though he may not be domiciled here, should be taxable here. But the statute exempts persons who, although resident within the province, have not formed that fixed intention to stay indefinitely which they must form to complete the requirements of a domicile of choice in Ontario. We think that it would be reasonable to extend the application of succession duties so that they would apply not only when the deceased was domiciled in Ontario but also when he was ordinarily resident in Ontario throughout the twelve months preceding his death. However, although a person can have only one domicile, it sometimes happens that he may have more than one place of residence for tax purposes. Furthermore, certain foreign jurisdictions use other criteria such as citizenship for determining tax liability. As a result, more than one jurisdiction may claim a death tax. In case of a jurisdictional dispute between provinces of Canada arising out of our proposal, the province of domicile of the deceased should prevail. In all other cases tax credits for foreign taxes paid would provide the appropriate relief. *We therefore recommend that*:

> ***Except where a deceased was domiciled in another province of Canada at death, a beneficiary of the deceased who was ordinarily resident in Ontario throughout the twelve months preceding his death be made subject to Ontario succession duty in the same circumstances that he would be subject to duty if the deceased were domiciled in Ontario at death.*** **28:1**

65. The parallel question of what property is situated in the province is answered by the law of situs. For property that is tangible and can be located physically, there are no problems; its situs is where the property is. Intangible property is another matter. A share in a company is really invisible, although there may be a piece of paper that represents it, or an office where it may be transferred, or physical assets of the company of which it represents some undivided, fractional ownership. The courts have ruled that a province has no power to establish rules of situs; consequently situs must be determined by those rules developed by the common law many years ago for purposes other than taxation. Because the nature of commerce has altered radically over the centuries, many of the rules ill fit the realities of the modern world. They are, however,

TABLE 28:6

TREATMENT OF PROPERTY PASSING ON DEATH UNDER THE SUCCESSION DUTY ACT

	Deceased domiciled in Ontario at death			*Deceased not domiciled in Ontario at death*		
Property at date of death	*Beneficiary domiciled in Ontario at death*	*Beneficiary resident in Ontario at death*	*Beneficiary neither domiciled nor resident in Ontario at death*	*Beneficiary domiciled in Ontario at death*	*Beneficiary resident in Ontario at death*	*Beneficiary neither domiciled nor resident in Ontario at death*
Real property in Ontario.........	Dutiable Section 6(a)	Dutiable Section 6(a)	Dutiable Section 6(a)	Dutiable Section 6(a)	Dutiable Section 6(a)	Dutiable Section 6(a)
Personal property in Ontario.........	Dutiable Section 6(a)	Dutiable Section 6(a)	Dutiable Section 6(a)	Dutiable Section 6(a)	Dutiable Section 6(a)	Dutiable Section 6(a)
Personal property outside Ontario.....	Dutiable Section 6(b)	Dutiable Section 6(b)	Not dutiable	Not dutiable	Not dutiable	Not dutiable
Real property outside Ontario.....	Not dutiable	Not dutiable	Not dutiable	Not dutiable	Not dutiable	Not dutiable

well understood, and at least have the virtue of certainty in any disputes that arise between jurisdictions recognizing the common law rules.

66. The general tax base of property passing on death for succession duty purposes is summarized in Table 28:6. It will be noticed that Ontario succession duty does not extend (a) to real property outside Ontario under any circumstances, or (b) to personal property outside Ontario if the deceased is not domiciled in Ontario at death, or (c) to any property outside the province if given to a beneficiary who is not domiciled or resident in Ontario at the time of death of the deceased.

67. By way of contrast, there is no constitutional restriction on the taxing powers of the federal government, and the Estate Tax Act of Canada takes advantage of this freedom. If the deceased person is domiciled in Canada, the federal government imposes tax not only in respect of property in Canada but also in respect of any type of property anywhere in the world. Should there be no assets in the hands of the executor available to pay tax, then primary liability shifts to the beneficiary. Sometimes, of course, collection is impossible when foreign assets are left to citizens of other countries. Further, the Estate Tax Act contains its own statutory situs rules which vary from the common law situs rules of the provinces. This difference between the federal and provincial situs rules creates problems with some estates. The effect can be to allow an abatement of federal estate tax for provincial tax in respect of some assets even though no provincial tax is paid, and to deny an abatement in respect of other assets on which a province does levy a tax.

68. Someone domiciled in Ontario could die and leave to Ontario beneficiaries an estate that includes shares in a company having transfer offices in British Columbia and Alberta. If the share certificates are physically located in British Columbia, the following taxes will be levied:

(a) British Columbia will levy duty on the value of the shares since they are situated in British Columbia;

(b) Ontario will levy duty on the value of the shares as there is a transmission in the province; and

(c) The federal government will collect estate tax on the value of the shares because the deceased was domiciled in a province of Canada.

But there will be no abatement for provincial tax under the Estate Tax Act if the shares have a statutory situs in Alberta, which does not levy any tax of its own. Ontario will allow a credit for duties payable to British Columbia not exceeding the amount of the Ontario duties on the transmission, as British Columbia has been designated under Section 9 of the Ontario Act. This same consequence would follow if foreign securities of this estate could not be transferred in Ontario but were transferable in a province such as Alberta for which the federal authorities collect the tax. While securities provide the most vivid examples, the problem flows directly out of the situs rules and can apply to other types of property.

69. It is a source of confusion to testators and executors that assets are treated differently under two death tax statutes in the same country. It is often difficult to know what is taxable and what is not. Such confusion constitutes a needless inconvenience for taxpayers. We believe that the situs rules of the federal and provincial statutes should be made uniform in order to reduce the confusion that now exists. Ontario's situs rules and those applicable in the federal legislation prior to the introduction of the Estate Tax Act in 1959, both based on common law, are well understood. On the other hand, the present federal rules are arbitrary and unique, and have lent themselves to tax avoidance. It would be helpful, therefore, if, in order to achieve uniformity, Canada would amend its situs rules to conform with those the provinces must use. Only a constitutional amendment would allow the provinces to change their rules to accord with those used by the federal government, but even if this obstacle were to be overcome, the result would be less satisfactory. *We therefore recommend that:*

> ***The Government of Ontario make representations to the federal government to change its situs rules to conform with those in force in the provinces, failing which the Government of Ontario request a constitutional amendment allowing the Province to adopt situs rules identical with those contained from time to time in the Estate Tax Act.*** **28:2**

70. Under certain circumstances Ontario quite properly taxes transmissions and dispositions of personal property situated outside the province at the time of death. Transmissions are transfers at the time of death, and dispositions are gifts made during the lifetime of the deceased. Taxable dispositions are treated for the purpose of the tax as if they were part of the estate at death. Personal property, taxed by Ontario either as a transmission or a disposition, may also be subject to tax by another jurisdiction in which the property is situated at death, whose right to tax is of equally high, or higher, priority. Under these circumstances, double taxation would result unless Ontario were to allow a credit. The credit allowed by Ontario is imperfect and incomplete. First, the credit is allowed only for transmissions and not dispositions, a discrimination for which we can find no justification. Second, the credit is not allowed for the death duties of all other jurisdictions. For example, an allowance is granted for all taxes imposed by the states of the United States, but not by the U.S. federal government. On the other hand, allowance is given for taxes paid to the central government of Australia, but not for those paid to the individual states. In our view, the credit should extend to all foreign taxing jurisdictions, and should amount to either the tax actually paid or the Ontario duty assessed on the assets in question, whichever is the lesser. Another related problem exists where Ontario duty is payable, because the deceased and beneficiary are both domiciled in Ontario, in respect of personal property situated in another province which does not itself impose any succession duty. Under these circumstances the estate is liable to full federal estate tax, with no abatement for provincial tax, because no tax is levied by the province in which the property is situated. However, the federal government gives that province a

share (now 75 per cent) of the federal tax collected in respect of the property under existing tax-sharing arrangements. The result is that tax is paid to that province in respect of the property just as certainly as if it had been levied by the province instead of the federal government; but, unfortunately for the beneficiary, Ontario does not allow any credit from its duties as it would have done if the province had collected the tax directly and there were a reciprocal tax credit provided. Accordingly, *we recommend that:*

> ***Tax credits be allowed from Ontario succession duty for taxes paid to another province of Canada or a jurisdiction outside Canada in respect of property that under Ontario's situs rules was situated therein, and for 75 per cent of federal estate tax in respect of property that under Ontario's situs rules was situated in a province that does not impose succession duty.*** **28:3**

71. Finally, we would like to mention the problems that can arise when the existing rules are interpreted differently by several jurisdictions with the result that each of two or more provinces claims that a property is situated in that province. This happens frequently with company shares. In such cases of "double" situs, the claim of the province in which the deceased was domiciled should prevail. If neither province was the province of domicile of the deceased, then tax priority should be given to the province in which the property was actually transferred, or, by agreement with the legal representatives of the deceased, the place where the property would be transferred. Ontario has generally adopted this approach for its own purposes and it should negotiate with the other provinces concerned to provide similar treatment. *We therefore recommend that*:

> ***Ontario take appropriate steps to eliminate double taxation resulting from differing interpretations of the common law situs rules that are made in other jurisdictions.*** **28:4**

PROPERTY PASSING ON DEATH

72. In general terms, all property passing on death is subject to duty. This includes all assets that an executor or administrator takes into his control. These are the assets that belonged to the deceased at the moment of his death and that he had power to dispose of by his will. Ordinarily, it covers most of the assets owned by a deceased including his house, furniture, bank accounts, stocks and bonds. Certain property that does not in fact pass on death is deemed by the Act to pass on death, e.g., joint property and life insurance. The English courts have ruled that property not owned by the deceased but in which he had an interest during his lifetime was dutiable as property passing on his death. For example, where a deceased has left his estate to his grandchildren subject to his son's prior life interest, tax is payable both on the death of the deceased and on the son's death when the assets are received by the grandchildren. Property is considered to pass on the son's death even though he did not own or control the assets. In Ontario, the Department does not follow this broader interpretation of the British courts,

and the question has never been litigated here. "Property passing on death" is interpreted in Ontario to exclude property in which the deceased had only a life interest. But tax imposts should not rest upon departmental practice. Statutory recognition should be given to what has always been the practice in Ontario and Canada of taxing only on the death of the owner of the property. *We therefore recommend that:*

> ***The Succession Duty Act be amended so as to make it clear that any property in which the deceased had a life interest but which he did not own is not property passing on death.*** **28:5**

73. There are certain interests in property that according to common law do not fall within the meaning of the words "property passing on death" and are not part of the estate of the deceased, but that are brought into tax as a matter of policy. Even property not owned by the deceased or that did not exist before the death of the deceased may be taxed. The problems that result from the inclusion of these other items are discussed in the following paragraphs.

JOINT PROPERTY

74. The first of the items deemed to be included in property passing is "any property held jointly by the deceased and one or more persons and payable to or passing to" one on the death of the other. The survivor is invested by law with the right of sole ownership regardless of the will of the deceased. The Ontario Succession Duty Act taxes the full value of jointly held property except for the proportion that the Treasurer is satisfied was contributed by the survivor.

75. Joint tenancy is a method of ownership used most frequently in dealings between members of a family. It is often used by husband and wife, and sometimes by brother and sister or parent and child. It is the poor man's will and the wife's protection. Quite often the family house and one or more bank accounts are held jointly. As long as the partners live, they each have an equal but undivided interest in the property so held. On the death of one of the partners, his beneficial interest is vested in the survivor or survivors.

76. The contribution test for taxing joint property has no time limit; the survivor is required to go back to the creation of the joint tenancy. The family house, the most natural gift between husband and wife, is subject to these severe restrictions, whereas other gifts of a whole interest in property are generally free from succession duty if made more than five years before death. In this context, the statute seems to treat joint property harshly.

77. The present method of taxation not only places a burden on the survivor to produce evidence of contribution but also discriminates against those beneficiaries who fail to keep such evidence for the lengthy time required. There is a marked contrast between the apparent usefulness and popularity of joint tenancy as a means of holding family property, and the tax burden that its use often entails.

On the other hand, those who obtain proper advice will find it comparatively easy to circumvent the consequences of this provision. In addition to creating this inconvenience or hardship for the taxpayer, the contribution test is difficult for the taxing authorities to administer.

78. In the former federal Succession Duty Act, patterned after provincial legislation, the same contribution test was employed; but when that Act was replaced by the Estate Tax Act, a new approach was adopted whereby all that is taxed is the legal beneficial interest of the deceased which at his death becomes vested in the surviving joint tenant. Thus, on the death of the husband, the wife's prior ownership of the joint property is recognized by the taxing statute even though the husband may have been the sole contributor. As the survivor, the wife receives the whole property on the death of her husband, but is taxable on her interest to the extent of any property contributed by the husband within three years of his death. It should be noted that the contributions made by the husband in favour of his wife are liable to gift taxes in the years when the gifts were made to the extent that the contributions exceeded his exemptions.

79. Several of the submissions made to us have suggested that the present practice regarding joint tenancies should be abolished and only the actual interest of the deceased person as evidenced by his beneficial ownership should be assessed. We think that the present method of assessment is less equitable than the ownership test, and that the contribution test results in undue administrative difficulties. We recommend later in this chapter that Ontario impose a gift tax which if implemented would ensure that where joint tenancies are created by way of gift, Ontario's revenue would be protected. *We therefore recommend that:*

> ***Upon the implementation of our recommendation for the imposition of a gift tax, Ontario adopt the test of "beneficial interest accruing by survivorship" as the method of valuing joint property regardless of source of contribution.*** **28:6**

80. One type of asset which is usually the common property of married couples is the furnishings of the home. Few couples bother about the question of formal ownership of household chattels, which are obtained at different times, frequently from different resources, and are treated as common property with such odd exceptions as "father's" chair in the living room. Thus it is often not easy to ascertain which spouse owns what at the date of death of one of them, or indeed who contributed directly or indirectly to the cost of acquisition, or in what proportion. We know that in the past the administration has found it difficult and occasionally impossible to account accurately for articles of household furniture. Further, we recognize that there is a natural annoyance when the surviving spouse is asked to swear an affidavit as to the ownership of the family sofa. We are of the opinion that all articles of ordinary household use should be exempt to the extent that they are received by the surviving spouse or, where there is no spouse, by a qualified dependant with whom the deceased lived. The term "ordinary household

use" should exclude valuable antiques and works of art and other extraordinary articles of value. *We therefore recommend that:*

> ***Articles of ordinary household furnishings which pass to the surviving spouse or, where there is no spouse, to a qualified dependant with whom the deceased was living at the time of his death, be exempt from duty.*** **28:7**

COMMUNITY OF PROPERTY

81. When a couple have married in a jurisdiction that recognizes community of property and have entered into a marriage contract to nullify the community, the assets of the estate of the deceased may be considerably distorted. Such jurisdictions as Quebec, some of the states of the United States, and many European countries have provision for community of property in their civil laws. Ontario courts recognize community of property in such cases, even when the couple accumulated all of their property after coming into Ontario, with the result that the survivor's undivided one-half interest in any property held in community is exempt from duty. In addition, a debt created by a deceased husband in favour of his wife, under a marriage contract entered into in order to avoid the community, is allowed in Ontario because the interest in the community that is given up is considered good consideration.

82. The result of this allowance is that a considerable tax advantage is frequently gained by those whose marriage is subject to community of property laws. On the other hand, it is likely that the existence of community of property is brought to the Treasury's attention only when a reduction in tax results. Certainly a good case can be made for giving a generous exemption to property passing to a succeeding spouse, as a means of providing for future needs, and of recognizing the partnership of a couple during the years of marriage. We do not believe, however, that recognizing community of property for the relatively few persons in that position is a satisfactory way of achieving this objective. *We therefore recommend that:*

> ***For the purposes of The Succession Duty Act, property held in community that was contributed by the deceased be deemed to be property passing on death, and a debt created by a marriage contract be disallowed as a deduction in determining the aggregate value of an estate.*** **28:8**

LIFE INTERESTS AND INTERESTS OF REMAINDERMEN

83. A life interest in the income from property of the deceased presents certain problems of valuation. The Ontario Succession Duty Act determines the present value of a life interest according to the life expectancy of the life tenant. For this purpose the Regulations provide that the valuation be made according to the 1937 standard annuity tables of the Actuarial Society of America, and at a compound interest rate of 4 per cent a year. The life interest is deemed to provide an income of 4 per cent per annum on the property, and the value of the life interest is determined by computing the present value of that income for the expectancy of the

life tenant at 4 per cent compound interest per year. The value of the interest in expectancy of the remainderman is determined by deducting the value of the life interest from the value of the property subject to the life interest.

84. We are convinced that the use of a mathematical formula, based on life expectancy tables and a fixed rate of interest, is the most equitable way of arriving at present value, even though it must be arbitrary. We believe that it would be unfortunate indeed if the Act, when valuing the life interest, were to recognize the specific yield of the assets in the estate, thereby giving an incentive to invest in low-yield assets to minimize the duties. It would also make administration impossible and impose a strain on taxpayer honesty if the health of the life tenant were to be considered. For these reasons, we support the practice of assessing life interests by a method similar to that provided in the present mathematical formula, but we believe that a more recent, currently accepted mortality table, together with current interest rates, should be used. *We therefore recommend that:*

> ***Life interests be valued according to a modern standard mortality table, and at a compound interest rate that more closely reflects current rates of interest.*** 28:9

85. The Succession Duty Act now provides for the payment of duty on a life interest in equal annual instalments without interest. The number of instalments is the lesser of ten or the number of years of the life tenant's life expectancy as determined by the prescribed mortality tables. If the life tenant elects to pay the duty at any earlier date, he is allowed interest at 3 per cent per annum from the time of payment until the due date. The remainderman may pay the duty on his interest at the time duties are ordinarily payable on bequests, i.e., within six months after the death of the deceased. If the duty is not then paid, it is payable within three months after his "interest in expectancy falls into possession", but the duty is then computed on the basis of the value at the time it falls into possession and not as at the date of death of the deceased. These provisions of The Succession Duty Act raise four fundamental questions:

(1) should a life tenant or a remainderman be required to pay his duties within six months of the date of death of the deceased if other moneys are available to him from the estate or if there is a power of encroachment upon the estate for his benefit?

(2) if a life tenant elects to pay his duties by instalments, for the purposes of computing the amount of each instalment should the number of instalments of duties be limited to a maximum of ten, or should the number be determined solely by his life expectancy?

(3) should the instalments of duties that a life tenant elects to pay be payable without interest? and

(4) should the life tenant be required to pay the annual instalments for as long as he lives, and if he dies without having lived the number of years used as the basis of computing the amount of each instalment should he be liable for the deficiency?

86. With regard to the first of these questions, we find it difficult to justify the present provisions of The Succession Duty Act that permit both the life tenant and the remainderman to defer payment of their duties. Where a deceased has left his estate outright to his beneficiaries, the duties are payable within six months of his death. The Province should not be expected to wait for the duties merely because a deceased chose to leave a life interest to one beneficiary and the remaining interest to another. Yet we recognize the problems of requiring a life tenant to pay duties on a life income that he has not received, and of requiring a remainderman to pay duties on property that he expects to receive in the future upon the death of the life tenant.

87. A possible solution to this difficulty would be to change The Wills Act[4] so as either to permit or require executors to pay the duties out of the estate, even though the deceased had not so provided in his will. We realize that with regard to existing wills, such an enactment might materially affect the proportions in which the beneficiaries would share in the estate. Therefore, if this course of action were to be adopted, at least one year's notice should be given so that all persons would have an opportunity to review their wills. While this solution has considerable appeal for us, we have concluded that inasmuch as this interference with the devolution of estates has more implications than the collection of revenue, we should not recommend it, but we do suggest that this proposal and all its implications should be examined carefully by the law officers of the Province.

88. We now turn to the second and fourth questions. In our view, where a life tenant elects to pay duty by instalments, the amount of each instalment should be computed solely on the basis of their continuing for his life expectancy without any maximum. On the other hand, we can find no justification for not including interest when computing the instalments. The present value of the life interest upon which the duty is levied is computed by allowing compound interest. Interest should be added at the same rate to the instalments of duty. Furthermore, we can see no justification for allowing an interest credit to life tenants who pay their duties in a lump sum rather than by instalments. *We therefore recommend that*:

The provisions of The Succession Duty Act permitting the life tenant of an estate to pay duties on an instalment basis be continued but **28:10**

(a) the amount of each instalment of duty be computed, having regard to his expectancy of life according to the standard of mortality prescribed for the purpose and not to any fixed maximum number of years, and

(b) the amount be payable in equal annual instalments of duty and compound interest computed at the same rate as is used for determining the value of the life interest.

[4]R. S. O. 1960, c. 433.

89. We now turn to the third question. We are concerned with the position of a life tenant who elects to pay his duties by annual instalments, and then dies in a few years, long before attaining the age shown in the mortality tables on the basis of which the present value of his interest, and hence his liability for duties, was computed. In this circumstance, the duties might well exceed the total amount of income actually received by him from the estate. On the other hand, if the remainderman's duties were computed on the value of his interest at the death of the deceased, this value, and hence his duties, would be much less than they would have been if the value had been computed on the basis of the actual life of the life tenant rather than on his expected life. If the life tenant lived longer than the life expectancy that was used to compute his duties, the amount of his duties would be less than they would have been if they had been computed on the basis of his actual life. The solution we suggest is that the life tenant be required to pay the instalment payments for the duration of his life, whether this be longer or shorter than the life expectancy upon which the instalments were computed. It should be realized that this method would not have exactly the same result as would be obtained if the duties on the life interest were recomputed on the termination of the life tenancy according to the duration of the tenancy. However, in our view the differences would not be of sufficient magnitude to offset the advantages, to both the administration and the life tenant, that would flow from the simple system that we suggest. Furthermore, there might still be difficulty for the estates of some life tenants to meet assessments for additional duties upon the termination of their tenancies. *We therefore recommend that*:

Where a life tenant elects to pay his duties on an instalment basis, the instalment payments be payable for the duration of his life tenancy whether this be longer or shorter than the life expectancy upon which the instalments were computed. 28:11

90. In some circumstances, the implementation of our recommendations concerning duties on life interests payable by instalments would require complementary changes in the treatment of the remainderman if both the revenue and equity are to be preserved. If the remainderman's duties were computed as at the death of the deceased, they should be recomputed upon the termination of the life tenancy having regard to its actual duration and either a refund made or additional duties collected. Where the remainderman's duties were not computed as at the death of the deceased, the remainderman will be subject to duties on the full value of the estate that comes into his possession at the termination of the life interest, without any allowance for the value of the life interest that was taxed against the life tenant. Under these circumstances no recognition should be given to the tax that was paid on the life interest. *We therefore recommend that*:

Where the life tenant has chosen to pay his duties by instalments and the duties payable by a remainderman have been computed and settled as at the date of death of the deceased, 28:12

the remainderman's duties be recomputed when he falls into possession, having regard to the actual duration of the life tenancy, and a refund be made or additional duties collected accordingly.

91. The Act now gives a life tenant the right to pay his duties within six months of the date of the death of the deceased, in which event he is allowed interest at 3 per cent per annum from the date of payment until the due dates of the various instalments that he would otherwise be required to pay. As we have already stated, we see no reason in equity for allowing interest. We believe, however, that the life tenant should be allowed to pay his duties in a lump sum. Wills usually provide for the payment of a beneficiary's duties from the estate, with the result that the life tenant's duties are usually not paid on the instalment basis. We suggest that, where a life tenant's duties are paid on the lump-sum basis, on the termination of the life tenancy there should be no recomputation of either his duties or the duties of a remainderman that were settled as at the date of the death of the deceased. The computations should be considered to be final, just as they are now. *We therefore recommend that*:

The provisions of The Succession Duty Act permitting the life tenant of an estate to pay his duties within six months of the death of the deceased be continued, but **28:13**

(a) no interest be allowed for paying at that time rather than by instalments, and

(b) the duties of the life tenant and those of any remainderman that were settled as of the death of the deceased not be recomputed upon the termination of the life interest.

92. Very often, the life income from part or all of an estate is left to one beneficiary and on his death to one or more other beneficiaries who thus have an "interest in expectancy" in the income—which they will enjoy if they are still alive at the death of the primary life tenant. Under the present provisions[5] of The Succession Duty Act, the duty on an interest in expectancy in income, if not paid within six months of the death of the deceased, is due when the interest in expectancy commences to be enjoyed, and is payable in equal annual instalments without interest. For the purpose of computing the instalments, the value of the interest in expectancy and the number of instalments are determined on the same basis as a life interest commencing with the death of the deceased, except that the value of the property and the expectancy of life of the beneficiary are established at the date that he commences to enjoy the interests, i.e., on the date of death of the primary life tenant.

93. The question arises, what treatment should be given under our proposed system to an interest in expectancy in income that would be enjoyed by a person

[5]R. S. O. 1960, c. 386, s. 16(7).

who survives the primary life tenant. We suggest that if the primary life tenant did not choose to pay his duties by instalments, the beneficiary of the interest in expectancy be permitted to settle his duties on any one of three bases: within six months of the death of the deceased; within six months of the date that the interest in expectancy commences to be enjoyed; or by instalments payable for his lifetime computed on the basis of his expectancy at the date his interest in expectancy commences to be enjoyed. However, if the primary life tenant chooses to pay his duties by instalments, we think that the duties of the primary life tenant as well as the succeeding life tenants should be computed as if they were all one person with a life expectancy determined on an actuarial basis for the group of such persons. The instalments of duty would likewise be computed on that expectancy and would be paid by the primary life tenant for his lifetime and commencing with his death by the succeeding life tenants for their lifetimes. Upon the death of the last of them the payments would cease and there would be no balance of duties to pay if none of the life tenants survived the life expectancy upon which the duties were computed. Upon the death of the last life tenant, the duties of a remainderman who had settled his duties as at the death of the deceased would be recomputed. Upon the termination of a life interest held by a secondary life tenant who had elected to pay his duties by instalments there would also be a recomputation of the duties of a remainderman who had settled his duties as at the death of the deceased. However, this recomputation would be on the basis of the period of the life tenancies being deemed to be the expectancy of life of the primary life tenant plus the number of years during which the income was enjoyed by any succeeding life tenant who paid his duties by instalments. *We therefore recommend that:*

The Succession Duty Act provide the following rules for the computation and payment of duties where one or more beneficiaries have an interest in expectancy in the income of an estate that would fall into possession upon the decease of a preceding life tenant: 28:14

(a) If the primary life tenant elects to pay his duties by instalments, the duties be computed on the basis of the life expectancy of himself and those beneficiaries that have an interest in expectancy in the income that would be enjoyed after the death of a predecessor life tenant; and such instalments be paid by him for his lifetime and after his death by each succeeding life tenant for the period of his enjoyment;

(b) If the primary life tenant chooses not to pay his duties by instalments, the duties on an interest in expectancy be payable,

(i) within six months of the death of the deceased,

(ii) within six months of the date he commenced to enjoy his interest in expectancy, or

(iii) by equal annual monthly instalments of principal and interest payable for his lifetime and computed according to his life expectancy at the date he commences to enjoy his interest in expectancy.

as the beneficiary may elect;

(c) If the primary life tenant elects to pay his duties by instalments, the remainderman's duties be recomputed when he falls into possession, having regard to the actual duration of the life tenancies, and a refund be made or additional duties collected accordingly; and

(d) If a succeeding life tenant elects to pay his duties by instalments, the remainderman's duties be recomputed when he falls into possession, having regard to a duration of the life tenancies deemed to be the life expectancy of the primary life tenant plus the number of years that the tenancy was enjoyed by the succeeding life tenant.

94. One more matter remains with respect to the computation of duties of a remainderman, or any other beneficiary of an interest in expectancy in capital, who elects to defer payment of his duties until he falls into possession. The Act provides that the duties shall be paid "on the basis of the value at the date of falling into possession of the property . . . and no deduction shall be made for any duty paid on or with respect to any prior interest, income or annuity arising out of the property. . . ."[6] The prohibition of a deduction for the duty paid in respect of any prior interest in the property seems to be unnecessary and of no practical effect. Where an estate has been reduced because of duties paid out of an estate under an exoneration clause, duties on the exonerated duties are payable by the beneficiary under Section 8, but they are payable on the date the remainderman's duties are payable and at the remainderman's rate. In effect, the remainderman pays a life tenant's duties on the exoneration since under the will of the deceased they are to be paid out of the estate leaving that much less for the remainderman.

ANNUITIES AND PENSIONS

95. Annuities and other income benefits purchased or provided by the deceased "either by himself alone or in concert or by arrangement with any other person" are dutiable under The Succession Duty Act "to the extent of the interest therein accruing or arising on the death of the deceased."[7] Life annuities, term annuities, and certain pensions, among other things, are subject to duty under this provision of the Act.

96. Like a life interest created under the will of the deceased, an annuity or taxable pension is valued according to prescribed annuity tables and at a compound

[6] R. S. O. 1960, c. 386, s. 16(5).
[7] R. S. O. 1960, c. 386, s. 1(p)(ii).

interest rate of 4 per cent per annum unless the annuity arises from a contract of insurance, in which event it is valued according to the standard of mortality and at the rate of interest on which the contract is based. This different method of valuation, where the annuity arises from a contract of insurance, was strongly criticized for a number of reasons in a submission presented to us. It results in identical annuities arising out of policies issued to the deceased at various times being valued at different amounts because varying standards of mortality and interest were used by the issuers. Such annuities might be valued on the basis of standards used in a period some forty or fifty years prior to the time of valuation, which do not accord with current standards. We have concluded that all annuities, including those arising from a contract of insurance, should be valued in the same manner. As with our recommendations in respect of life interests, we think that current standards of mortality and interest should be used rather than those at present prescribed. *We therefore recommend that*:

> ***An annuity, pension or similar income contract be valued according to a modern standard mortality table and at a compound interest rate that more closely reflects current rates of interest.*** 28:15

97. The case for the payment of duties by instalments is, if anything, stronger for life annuities and pensions than for life interests. If the recipient of the annuity or pension dies before attaining the expectancy of life upon which the value of the contract was computed, with the result that the contract is terminated with no residual payments to his estate or to anyone else, the duties levied will not correspond with the value of the payments actually realized by him from the contract. If he were required to pay the duties on the annuity or pension in a lump sum within six months of the date of death, he would, in the circumstances outlined, get no relief from the overcharge. In our view, he should have the right to pay his duties by instalments, whether other funds are available to him from the estate or not. As in the case of a life interest, the number of instalments should be determined solely on his life expectancy and interest should be included in computing the amount. The instalment payments should continue for the duration of the contract, whether this be a longer or shorter period than the expectancy of life upon which the instalments were computed. We are satisfied that the Province would not lose revenue by requiring payment of the annual instalments only for so long as the beneficiary enjoys the benefits from the contract, since the excess payments made by persons living longer than their life expectancy would compensate for the deficiency in the payments made by those living for a shorter time than their expectancy. There is no inequity to a beneficiary who must pay additional instalments of duty by reason of living beyond the expectancy of life upon which his duty was computed, as he will enjoy commensurate additional income from the contract. In the event that a contract provides that on the death of the annuitant any residual value be paid to another person, that other person should be required to pay duty on the amount received on the same basis as used for computing the instalments of duty payable by the annuitant. *We therefore recommend that:*

The provisions of The Succession Duty Act permitting the beneficiary of an annuity, pension or similar income contract to pay duties on an instalment basis be continued, but that **28:16**

(a) the computation of the equal annual instalments of duty include compound interest at the same rate per annum as is used for determining the value of the contract,

(b) the amount of each instalment of duty in respect of a contract providing payments for life be computed having regard to the beneficiary's expectancy of life and not to any fixed maximum number of years,

(c) the amount of each instalment of duty in respect of a contract providing payments for a term certain be computed having regard to that term and not to any fixed maximum number of years, and

(d) such instalments be payable for each year during which payments are received under the contract and, where the contract provides payments for life, no further amounts of duty be payable upon termination of the contract before the beneficiary reaches the expectancy of life upon which the duty was computed.

PAYMENTS FROM EMPLOYERS OF THE DECEASED

98. Employers often make gratuitous payments to the estates of deceased employees or to persons who were dependent upon them. These include pensions, annuities, lump-sum payments and other benefits that neither the deceased's estate nor the dependant have any legal right to enforce. At present, Ontario does not subject any of these amounts to succession duty. The federal Estate Tax Act, on the other hand, includes in the aggregate value of an estate the value of all payments made voluntarily in recognition of services rendered by the deceased as an employee, whether the payments are made to his estate, to a member of his family or to anyone else.

99. We think that all such payments constitute benefits which should be subject to duty. Not to tax these benefits leaves open the door to duty-free payments which in appearance are spontaneous and voluntary, but which may be, and often are, contemplated prior to death. Because the total amount of these payments may not be determined at the time of the filing of the succession duty return, provision should be made for reassessment whenever the circumstances warrant. Provision should also be made for payment of duty by instalments where the benefits are paid to the beneficiary in the form of an annuity or by a series of payments and the beneficiary has received insufficient other funds from the estate to finance the payment of the duty. *We therefore recommend that*:

All payments made voluntarily on or after the death of a deceased employee in recognition of services rendered by him be dutiable, with provision for payment by instalments under those circumstances where instalments would be permitted according to our recommendation 28:16 concerning annuities. 28:17

LIFE INSURANCE

100. Under the present Succession Duty Act, the proceeds of life insurance policies paid directly to a beneficiary are included in the aggregate value of the estate and made subject to duty in four circumstances. First, if the policy is on the life of the deceased, the proceeds of the policy are included in the proportion that the amount of the premiums paid by the deceased bears to the total premiums paid. For this purpose premiums are considered to have been paid by the deceased if they were paid on his behalf or in respect of him by his employer. As used here and later in this paragraph, "employer" includes a business or company with which the deceased was associated or in which he was interested. Second, the Act requires the inclusion of the value of any interest held by the deceased in a policy of insurance on the life of another. Third, if the policy is on the life of the deceased but is owned by his employer, any part of the proceeds of the policy paid to any other person or not retained by the employer is included. Finally, if the employer of the deceased had some interest in a policy on the life of another person, any part of the proceeds received by the employer and paid to any member of the family of the deceased is included. Both the third and fourth instances are quite rare; they are the nearest that Ontario now comes to taxing voluntary payments made by an employer to a member of the family of a deceased employee. Our immediately preceding recommendation is broad enough to include voluntary payments, made in recognition of services rendered by a deceased employee, that emanate from life insurance policies owned by his employer. The second situation probably does not require specific mention in the statute since it is likely taxable simply as "property passing on death". The most common situation is the first, which calls for the assessment of insurance on the basis of the payment of insurance premiums, i.e., the "premiums test". If the deceased paid all the premiums, then the whole proceeds are included in the value of the estate. If he paid 50 per cent of the premiums, then only half of the proceeds will be included.

101. A quite different approach to life insurance proceeds is taken in the federal Estate Tax Act, under which liability for tax is determined on the basis of the legal ownership of policies. Ownership, however, is given an extended meaning in the Act, and includes policies over which the deceased had only slight control. Moreover, Canada may tax insurance proceeds should there be a failure to register a change in ownership of the policy with the insurance company, even though by agreement made prior to his death the deceased had sold or otherwise disposed of all his rights under the contract. In general, however, this approach to the assessment of insurance corresponds more closely to the treatment of other assets than does Ontario practice.

102. It is relatively easy to avoid tax with either test, given adequate knowledge and a willingness to be methodical about handling one's affairs. The ownership test makes avoidance perhaps a little easier since a once-and-for-all action suffices. The premium or "contribution" test requires continuing vigilance. After careful consideration, we are not convinced that there is sufficient justification for treating life insurance proceeds differently from other kinds of property. We think that the ownership test is best suited for tax purposes and is fairer in terms of the expectations of most people. Our recommendations respecting gift taxes later in this chapter will tend to decrease the amount of tax avoidance to which life insurance contributes. *We recommend that:*

> ***Upon the implementation of our recommendation for the imposition of a gift tax, the proceeds from policies of life insurance payable as a result of the death of the deceased be deemed to be property passing on death only to the extent that the policies were owned by the deceased.*** **28:18**

PROPERTY PASSING FOR PARTIAL OR FULL CONSIDERATION

103. There is no provision in The Succession Duty Act that allows for consideration, whether partial or full, paid or payable by the beneficiary for property that passes to him, or that is deemed to pass to him, on the death of the deceased. On the other hand, the Act does recognize partial consideration in respect of dispositions. For example, many people give away property during their lifetime by establishing trust settlements to benefit others, or by other means. All such settlements and other gifts, whenever made, are brought into the estate for succession duty purposes where the deceased had retained some control or enjoyment for himself, however slight. However, under the Act any consideration given in respect of trust settlements is not recognized. A common example of a taxable trust settlement is where a father gives a farm to his son reserving to himself the right to live in the house. That the settlement might have been made because the son had worked on the farm for years without remuneration is not recognized by the statute. In practice, however, the Department does make an allowance for partial consideration by analogy with the provision relating to dispositions. It is proper that such a consideration be allowed, and statutory authority should be provided for it. *We therefore recommend that:*

> ***For purposes of succession duty, statutory recognition be given to the present practice of making allowance for partial consideration in valuing property passing or deemed to pass on the death of the deceased.*** **28:19**

AGREEMENTS FOR SALE AND PURCHASE

104. The Act takes notice of any right held by a person to purchase property given by the deceased under a firm contract or an option taking effect after his death. If the agreed purchase price under a firm contract is less than the fair market value, both at the date of the contract and the date of death of the deceased,

the purchaser is liable to duty on the difference. If the purchase price under an option is less than fair market value at the date of death of the deceased, the purchaser must likewise pay duty on the difference. Having in mind all the possibilities of abuse that would be opened by any more favourable treatment, we believe that the present provisions should be retained.

DISPOSITIONS

105. Unless provision were made to prevent it, a considerable loss in duties would occur as a result of people giving away their property or selling it for less than fair market value when death becomes imminent. Thus, the Ontario statute imposes duty on all dispositions whenever made, and then exempts those made beyond five years of death. The Act includes a long definition of the word "disposition" which is designed to encompass gifts and benefits of every kind made or conferred directly or indirectly by the deceased during his lifetime.

106. The rules for determining which dispositions shall be dutiable are necessarily quite complex, since they take account of the domicile of the donor and the residence of the donee both at the time of disposition and at the time of death, as well as the location of the property and the place where the transfer took place. All dispositions are included in the aggregate value of an estate, but not all of them are dutiable. Table 28:7 shows the circumstances in which dispositions are dutiable and the supporting statutory authority.

107. Canada and the United States, as well as British Columbia, include only those dispositions made in the three-year period prior to death. The first two jurisdictions also impose gift taxes, which help to protect death tax revenues; and they appear to have experienced no significant loss of revenue resulting from the shorter period. If Ontario were to introduce a gift tax in such a manner as to be an effective complement to its succession duty, we feel that it would be unnecessary for the succession duty to reach outright dispositions made more than three years before death. Accordingly, *we recommend that:*

> ***The Succession Duty Act be changed to exempt absolute dispositions made more than three years before the death of the deceased rather than five years, as at present.*** **28:20**

108. The present Ontario Succession Duty Act requires that all dispositions made by the deceased during his lifetime be reported in a sworn statement made by all the executors and all the beneficiaries of the estate. Outright gifts made more than five years before death are then exempted from duty. This requirement for an exhaustive list undoubtedly causes much annoyance and delay in completing the basic returns for the estate and does little to improve the effectiveness of the statute. It is an unusual and onerous provision with which many executors and beneficiaries find it impossible to comply; often only a perfunctory attempt to do so is made. *We therefore recommend that:*

TABLE 28:7

TREATMENT OF DISPOSITIONS UNDER THE SUCCESSION DUTY ACT

	Deceased domiciled in Ontario						*Deceased not domiciled in Ontario at death*		
	At date of death and at date of disposition			*At date of death only*					
	Donee			*Donee*			*Donee*		
Property at date of death	*Resident in Ontario at date of death and date of disposition*	*Resident in Ontario at date of death only*	*Not resident in Ontario at death*	*Resident in Ontario at date of death and date of diposition*	*Resident in Ontario at date of death only*	*Not resident in Ontario at death*	*Resident in Ontario at date of death and date of disposition*	*Resident in Ontario at date of death only*	*Not resident in Ontario at death*
Real Property in Ontario.	Dutiable Section 6(c)	Dutiable Section 6(c)	Dutiable Section 6(a) and 1(p)(ix) and (x)	Dutiable Section 6(c)	Dutiable Section 6(c)	Dutiable Section 6(a) and 1(p)(ix)	Dutiable Section 6(c)	Dutiable Section 6(c)	Dutiable Section 6(a) and 1(p)(ix)
Personal property in Ontario (disposition made in Ontario).	Dutiable Section 6(c)	Dutiable Section 6(c)	Dutiable Section 6(a) and 1(p)(ix)	Dutiable Section 6(c)	Dutiable Section 6(c)	Dutiable Section 6(a) and 1(p)(ix)	Dutiable Section 6(c)	Dutiable Section 6(c)	Dutiable Section 6(a) and 1(p)(ix)
Personal property in Ontario (disposition made outside Ontario).	Dutiable Section 6(a) and 1(p)(x)	Dutiable Section 6(a) and 1(p)(x)	Dutiable Section 6(a) and 1(p)(x)	Not dutiable	Not dutiable	Not dutiable	Not dutiable	Not dutiable	Not dutiable
Personal property outside Ontario (disposition made in Ontario).	Dutiable Section 6(c)	Dutiable Section 6(c)	Not dutiable	Dutiable Section 6(c)	Dutiable Section 6(c)	Not dutiable	Dutiable Section 6(c)	Dutiable Section 6(c)	Not dutiable
Personal property outside Ontario (disposition made outside Ontario).	Dutiable Section 6(d)	Not dutiable	Not dutiable	Not dutiable	Not dutiable	Not dutiable	Not dutiable	Not dutiable	Not dutiable
Real property outside Ontario	Not dutiable	Not dutiable	Not dutiable	Not dutiable	Not dutiable	Not dutiable	Not dutiable	Not dutiable	Not dutiable

The affidavits of executors and beneficiaries be required to include only those absolute dispositions made within three years of death of the deceased and dispositions not to the exclusion of the donor, whenever made. **28:21**

109. When dispositions are made that are subject to federal gift tax, the amount of such tax paid reduces the donor's assets, and if he dies within the three-year period his estate is smaller by the amount of the tax paid. The federal estate tax, however, brings back into the tax base the amount of the gift and then gives a credit against estate tax of the amount of gift tax paid within the three-year period. The result is that from an estate planning point of view there is an advantage for a man who, prior to his death, makes gifts that attract gift tax at a rate no greater than his prospective effective estate tax rate. This advantage is inequitable. Any gift tax paid with respect to dispositions that are included in calculating the aggregate value of the estate should likewise be included to the extent that it may be recovered as a deduction from estate tax or a refund of gift tax. This would become even more important if Ontario were to impose its own gift tax in accordance with the recommendation we make later in this chapter. Hence, *we recommend that:*

The amount of any gift tax payable by the deceased in his lifetime be dutiable to the extent that it is recoverable as a deduction from federal estate tax or provincial succession duties or by way of refund of gift tax. **28:22**

110. The valuation of dispositions gives rise to problems. As a general rule, gifted property is valued by Ontario at its value at the time of the donor's death. Exceptions are made for gifts of money, which are valued at the actual amount received, and gifts that have been converted into money prior to death, which are valued at the amount realized. Thus very often informed people will give cash with which the intended gift will be purchased, rather than giving the property itself. Rights to enjoy income and remissions of debt are valued at the date of disposition. Little imagination is needed to realize that valuation at the date of death must lead to many difficulties, particularly in such cases as shares in a company to which many things may happen in a comparatively short time, or to personal property which may be damaged. An interesting problem arises with such gifts as boat tickets which are used in the interval between the making of the gift and death—a gift of cash to buy the ticket would be treated quite differently. This rule may work either to the advantage or to the disadvantage of a person receiving a disposition. On balance, however, we think that equity would be improved if all dispositions were valued at the date of disposition. Hence, *we recommend that:*

A disposition be valued as at the date of the disposition. **28:23**

THE STANDARD OF VALUE

111. For the purposes of The Succession Duty Act, all assets comprising the property of the deceased are taken at their "value", although value itself is not

defined. In some instances, there is clear direction about the valuation of specific kinds of property. Thus, stocks and bonds, which are regularly traded, are valued at quoted market prices as of the close of trading on the date of death. A large block of shares, representing substantially less than effective control, might bring less than the quoted market price if an attempt were made to sell them in a short period of time. Conversely, a block that represented effective control would command a premium above quoted market prices. For most assets, no specific direction is given in the Act as to how "value" is to be established. Delays in settling duties result from this lack of precision in the statute. We believe that the Act ought to give a clearer direction without, however, resorting to that kind of legal precision which so frequently begets unexpected results. Fair market value is a concept well understood in common law, and in our opinion should be the general principle by which value for most assets is established. We have every reason to suppose that this principle, coupled with an effective right of appeal, would help to ensure proper valuations. *We therefore recommend that:*

> ***The Succession Duty Act require that as a general principle all dutiable property be valued at its fair market value.*** **28:24**

VALUATION DATE

112. In general, the only relevant time for valuing property of the deceased is the date of death. We would make an exception for dispositions to reflect the fact that gifted property may be sold before death or be of such a nature that its value diminishes after the transfer and before death. Our recommendations in this area are set forth in a previous section of this chapter. Another exception concerns property passing to a remainderman who chooses to settle his duties on the basis of the value of the property as at the date that it falls into his possession. Generally, however, we believe that the date of death is a satisfactory time for purposes of valuation.

113. Suggestions have been made to us, and to the Government of Ontario, that provision should be made for an alternative valuation date. The major argument supporting an alternative date is that the date of death is invariably a time when it is impossible to deal with the assets. It is of little comfort to a beneficiary to tell him his shares are worth $100,000 and demand tax on that basis if by the time he receives the shares and can deal with them they have become worth only $10,000. The counter-argument is that serious administrative difficulties would be encountered if each beneficiary liable to pay duty were allowed a choice of two valuation dates. But, since responsibility for duty rests on the successors, it is argued that each should have the option of choosing whichever date better suits him.

114. We recognize the force of both arguments but are particularly impressed with the inequities that can and do arise through a loss in the value of assets between the date of death and the earliest possible moment of realization. On the other hand, we do not want to recommend a provision that might lead to a chaotic valuation problem for the tax administrators. If the executors were allowed by

statute to make a binding decision for all beneficiaries, the administrative difficulties would be eliminated, although the choice might not necessarily be to the advantage of every beneficiary.

115. One question remains: how long after death should the alternative date be established? The United States allows an alternative date of one year after death. The result, we are advised, is that most administrations of estates are delayed until the year is past to ensure that no advantage is lost. From an administrative point of view, this period seems unreasonable. Estate handling is already a sufficiently leisurely process requiring no incentive to further delay. With reasonable attention, assets of most estates could be transferred into the hands of the executors or beneficiaries within five months. Accordingly, we suggest that an appropriate alternative valuation date would be 150 days after date of death. Such a date would require no change in the date on which duty is payable—six months after death. If the option for the alternative valuation date were taken, assets that are sold during the 150-day period would, of course, be valued at the amount realized from their sale. *We therefore recommend that:*

> ***The executor or administrator of an estate be given statutory authority to elect, on behalf of the beneficiaries collectively, that dutiable property and transmissions be valued as at 150 days after the date of death, except that assets sold before that date to persons with whom the executor was dealing at arm's length be valued at the amounts realized on their sale.*** 28:25

QUICK SUCCESSION

116. It sometimes happens through unhappy choice, that a beneficiary dies shortly after his benefactor. In such cases the property involved is taxed twice within a brief period, possibly even before the first beneficiary has had time to enjoy his inheritance. The federal Estate Tax Act makes provision for such quick successions by allowing a reduction in the value of property of an estate that had been inherited within five years before death, including property exchanged or substituted for that property. The reduction is 50 per cent of the value where the second death occurs within one year of the first death, and declines by 10 percentage points for each year thereafter that the beneficiary survived his benefactor.

117. Admittedly, the tax appears unduly burdensome if it is levied twice with respect to the same assets within a very short time, as can now happen under the Ontario Succession Duty Act. We are convinced, however, that any resulting inequity is more apparent than real. If the exemptions allowed to beneficiaries are appropriate to their circumstances, and if the rates of duty are also appropriate, the need for relief in cases of quick succession is greatly diminished. Our careful study of this question has impressed us with the technical difficulties of applying relief within the legal context of an inheritance tax. If a very large allowance were provided for cases of deaths that were very close in time, the provisions that would be necessary to ensure equity would require that same degree of complexity

for which we criticize many parts of the present statute. If the allowance were low, the provisions would not need to be so complex, but the relief would be less. We have therefore concluded after lengthy consideration that the reasons supporting relief in cases of quick succession do not warrant the administrative difficulties that provision of such relief would entail.

DEDUCTIONS, EXEMPTIONS AND CALCULATION OF TAX

118. Allowances or deductions are made in three stages of the computation of succession duties under the present Act: (1) in determining the aggregate value by which the rate is set; (2) in fixing the dutiable value on which the duty is levied; and (3) in arriving at the amount of duty. This section deals with the nature and amount of these allowances and deductions and the steps involved in the calculation of duty. Before beginning this detailed discussion, we would like to consider some of the relevant terms used in the Act. Careful choice and consistent use of words can lend clarity to any literary work. As the wording of statutes is of peculiar import, we suggest certain modifications in terminology intended to assist those who must understand The Succession Duty Act.

119. "Aggregate value" is defined in the statute as the value at the date of death of the deceased of all the property wherever situate passing on his death (including transmissions) and the value of all dispositions wherever made, less the debts, encumbrances and certain allowances and exemptions as specified in the Act. It encompasses the over-all estate on a world-wide basis, and from it the basic or initial rate of duty is established. Since this amount is arrived at by a calculation involving the subtraction of debts, encumbrances and certain allowances and exemptions, we suggest that it might better be called the *"aggregate net value"*. We suggest further that all items that are subtracted in arriving at the "aggregate net value" be called "deductions", so as to distinguish them from the other allowances or exemptions that are not deducted in computing the "aggregate net value" but are taken into account when computing the amount of duty payable by a particular beneficiary.

120. "Dutiable value" is a term used in the Act with reference to a particular property, transmission or disposition; it means the value of the property, transmission or disposition less such of the "deductions" for debts, encumbrances, allowances or exemptions as are applicable to it. The "aggregate net value" is in effect the sum of the dutiable values of the individual properties, transmissions and dispositions comprising the estate. Although the method of computing tax which we recommend later in this section will include no direct counterpart to the present "dutiable value", it will still require a calculation of the net value of the assets attributable to each beneficiary that are taxable by Ontario. The gross value of the assets ascribed to each individual is reduced by the amount of any specific debts pertaining to those assets, and by the value of any foreign property that Ontario cannot tax. We have called the total net value of all the assets on which any one beneficiary would be taxed the *"aggregate taxable value"*.

LIABILITIES OF THE DECEASED

121. All legitimate debts of the deceased may be deducted from the gross value of the estate. For this purpose, liabilities, like assets, may be located anywhere in the world. Similarly, specific debts or liabilities are deducted in computing the "aggregate taxable value" of property passing to the beneficiaries, i.e., the value on which the duties are to be levied. However, no provision is made for liabilities of the deceased at his death the existence or amount of which had not been determined when the succession duty return was filed. In addition, no specific provision is made for contingent liabilities of the deceased, which may or may not become payable in the future. These would include damages contingent upon a threatened or actual law suit or an amount which may become payable as a result of a guarantee of an obligation of another person given by the deceased. If the existence or amount of a liability is determined or if a liability that was contingent at death becomes payable before the duty is settled, a deduction is allowed. Otherwise, except where the duty is paid with a specific reservation, no relief may be available after the statutory time for refunds has expired. It is proper that all legitimate obligations of the deceased be recognized. As a general rule, any contingent liability that was incurred in good faith and for full consideration paid or agreed to be paid to the deceased for his own use or benefit or any contingent liability that arose from his own tort, should be recognized as an obligation of the deceased if, as and when it becomes payable, and duties already settled should be recomputed and, if necessary, refunds made regardless of the present time limit. To avoid unreasonable administrative inconvenience, however, no adjustment should be made if an amount subsequently found to be payable in respect of a liability contingent at death does not exceed $1,000 and the duties have already been settled. *We therefore recommend that:*

Appropriate provision be made for adjusting or refunding duties when a liability, including a liability that was contingent at the death of the deceased, becomes payable after the duties have been settled, provided the liability or liabilities so payable exceed $1,000. 28:26

EXPENSES OF THE ESTATE

122. Certain expenses connected with the death of the deceased and with the administration of the estate are now allowed as deductions in computing the aggregate value of the estate. Generally, funeral expenses are automatically allowed if they are billed to the estate by a funeral home director. However, sometimes expenses are not allowed when the Department considers them to be unreasonable. These expenses generally must be accounted for by the executors of the estate, and in our opinion, if properly supported, should be deductible. *We recommend that:*

All expenses in connection with the death and funeral of the deceased that are paid from the estate be treated as deductions in computing aggregate net value. 28:27

123. The Act makes a specific allowance for surrogate court fees. It is proper that this deduction be given, since it diminishes the value of the estate available for distribution to the beneficiaries. While no deduction is allowed for executors' fees, solicitors' fees for obtaining probate or letters of administration are allowed to an amount not exceeding $100, an amount that has been likened to the traditional dollar used to disinherit relatives. In our view, it is appropriate to allow a deduction for necessary legal fees. In most cases the services of a lawyer must be obtained and the money paid for these services is not available for distribution to the beneficiaries. We consider that legal fees should be deductible to the extent that they are incurred for such services as obtaining probate or letters of administration and filing estate tax and succession duty returns. The various county law associations have established standard tariffs for these services. The allowance should be the lesser of the amount actually paid and the standard tariff. *We therefore recommend that:*

> ***Amounts paid, not exceeding the standard tariff of the applicable county law association, for legal services in preparing application for and obtaining probate or letters of administration, preparing succession duty and estate tax returns, and preparing notarial copies of letters probate or letters of administration, be allowed as deductions.*** **28:28**

CHARITABLE DONATIONS AND BEQUESTS

124. The statute allows an exemption from duty on dispositions and bequests to religious, charitable and educational organizations, and provides further that such dispositions and bequests are not to be included in the aggregate value of the estate. (Of course, such dispositions made beyond five years of death are exempt without this special provision.) Their exclusion from the aggregate value produces a remarkable anomaly in the operation of the statute. For example, where an estate of substantial size is divided between two children, each child's duty is calculated on one-half of the aggregate value of the estate that he receives. The rates of duty payable by each are determined having regard to the aggregate value of the estate for the initial rate, and to one-half of the aggregate value for the additional rate. Had the children been given from the estate legacies of the identical amounts that remained to them after payment of the duties, with the residue of the estate going to charity subject to payment of the duties on the legacies to the children, the result would have been quite different. While the children would have received the same after-duty amounts, the duties would have been significantly smaller and charity would have received a bequest equal to the saving in duties. This saving arises for three reasons. First, the Act provides that the duty levied on the benefit to the children arising from the estate paying their duties is to be computed at the same rate as would have been payable if there had been no duty exoneration clause in the will. If there had been no duty exoneration, the greater amount that the charity would have received as residuary legatee would have been free of duty because the charity is exempt. As the charity would have had a nil rate, the rate payable by the children on the exoneration is likewise nil. The second reason for

the savings in duties is that the amount left to charity is deducted in arriving at the aggregate value of the estate and so a smaller initial rate of duty applies to the legacies to the children. The third reason is that the additional rate of duty is determined on the basis of the amounts of the legacies to the children—the net amounts that it is intended the children should get after payment of all duties—and not on the gross amounts before payment of duties as would have applied if the estate had merely been divided between the two children. It will readily be seen that by making a charity the residuary legatee it is possible to increase the amounts which the children will receive and still leave a significant amount for the charity. This, while available only once to any person—and then only at his death—can sometimes be a very profitable operation for the taxpayer at the expense of the treasury. The federal Estate Tax Act avoids this anomaly by its different structure and by allowing as a legacy to charity only the amount actually received by the charity from the residue of the estate after payment of succession duties on behalf of taxable legatees.

125. Under certain circumstances, because of the peculiar working of the present provisions of the Act concerning bequests to charity, the amount retained after duties by the family of a deceased may be greater where he left the residue of his estate to charity than it would be if he had left it all to his family, notwithstanding that after the payment of the duties no residue actually remained for charity. For example, if an estate of $1 million was divided equally between two children, the duties of 15 per cent and the surtax of 15 per cent would amount to $172,500 leaving $827,500 for the children. However, if $875,000 was bequeathed to the two children in equal portions, with the direction that the duties be paid out of the estate, and the residue of $125,000 was bequeathed to charity, the amount left to charity would be exempt and the estate would pay duties of 14.05 per cent and surtax of 15 per cent, amounting to $141,378, on the $875,000 left to the children. After paying the duties, the balance in the estate would be $858,622, all of which would go to the children since it is less than the amount of $875,000 bequeathed to them; and since there would be no actual residue, the charity would get nothing. The result, as far the children are concerned, is that they would gain over $31,000 at the expense of the Ontario treasury.

126. The particular working of this section is inequitable. The statute should be as neutral as possible in its influence on the organization and distribution of estates, and this requires the removal of the anomaly. In keeping with our justification of this tax, we believe that dispositions and bequests to charitable organizations should not be deducted in computing the aggregate net value of the estate for the purpose of determining the rates of duty applicable to dutiable dispositions and bequests. This should apply whether or not the legal form of the gift is subject to prior interest or other contingencies.

127. Representations have been made to us to extend the scope of the exemption of charities to organizations of a religious, charitable or educational nature outside Canada. Although we are sympathetic with the motives of such suggestions, we fear that with the limited information available to a province the adminis-

trative problems of determining bona fide charities in foreign countries would be too great. However, if the federal government is prepared to certify foreign organizations as eligible for tax exemption, Ontario could very well extend its exemption to these bodies. For the above reasons, *we recommend that:*

(a) Dispositions to bona fide religious, charitable and educational organizations made within three years of the death of the deceased be included in the aggregate net value of an estate; 28:29

(b) bequests to bona fide religious, charitable and educational organizations not be deductible in computing the aggregate net value of an estate; and

(c) such dispositions and bequests be exempt from duties to the extent of the amounts actually paid or payable to such organizations outside Canada as may be prescribed by the Lieutenant Governor in Council and to all such organizations in Canada.

TREATMENT OF FAMILY AND DEPENDANTS

128. It is apparent from The Succession Duty Act that legislators have been concerned to give preferential tax treatment to relatives of the deceased, and especially to those who were dependent upon him for their support. Four different techniques have been adopted to achieve this objective.

129. The first and most obvious provision is the differential rate structure which distinguishes between three classes of beneficiaries: "preferred",[8] or immediate family; "collateral",[9] the less immediate but still close relatives; and strangers, all others. The rate structure employs two techniques to achieve a preferential treatment. In the first place, the prescribed rates of duty and surtax increase from preferred, to collateral, to stranger. The combined minimum rates and surtax are 2.875 per cent, 3.0 per cent, and 15.625 per cent respectively. Secondly, by failing to provide rates of tax until certain values have been reached, the Act allows larger exemptions to close members of the family. No rate of duty is applied to the part of an estate passing to a preferred beneficiary if the aggregate value of the estate does not exceed $50,000. If an estate of $20,000 or less is divided among collateral beneficiaries so that none receives more than $10,000, no duty is payable. By contrast, a stranger must pay duty regardless of the amount of his inheritance if the aggregate value of the estate exceeds $10,000.

130. A second provision in the statute is that the value of certain small annuities given to a wife or a dependant and created prior to the date of death are excluded from the estate. This exemption applies only to a non-commutable

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[8]Preferred beneficiaries: father, mother, husband, wife, grandfather, grandmother; son-in-law, daughter-in-law, child, and adopted child of the deceased, and the lineal descendants of a child or adopted child of the deceased.

[9]Collateral beneficiaries: brother, sister, descendant of brother or sister, uncle or aunt, descendant of uncle or aunt, and lineal ancestor other than parent or grandparent.

annuity (one that does not give the annuitant the right to take a lump-sum settlement in lieu of the annuity) and is limited to $1,200 per annum to one person and $2,400 in all. The younger the annuitant, the higher the capitalized value of the annuity and hence the greater the saving in duty from the exemption. For instance, a life annuity of $1,200 for someone 50 years of age would be valued, if dutiable, at approximately $17,400; the value for someone 38 years old would be nearly $21,000. By its exclusion from the aggregate value, the exemption has the effect of reducing the rates of duty applicable to all beneficiaries as well as exempting the annuity.

131. A third form of preferential treatment given to those close to the deceased is the dependant's allowance. The effect of this provision is to create a fourth class of beneficiary, comprising the widow or infirm husband and dependent children of the deceased. The provision allows bequests up to $75,000 to pass free of tax to a widow, or infirm husband where there is also a dependent child, and $15,000 to a dependent child of the deceased. A dependent orphaned child may receive $25,000 without attracting duty. These allowances are cumulative in the sense that they may be allocated among several dependants in any proportion without attracting duty. For example, a wife with two dependent children may be given an allowance of $105,000 comprising $75,000 of her own and $15,000 for each child. Once the benefits to a dependant exceed the amount of the allowance, however, the entire benefit becomes dutiable, not just the portion in excess of the allowance.

132. The fourth and final type of consideration given is the dependant's reduction. The wording of the provision is extremely complex, and it is probably better to explain the results rather than the actual legislation. An individual dependant's reduction decreases the amount of tax that would otherwise be payable by a widow, infirm husband or dependent child of the deceased. The amount of the reduction is based on the duty that would be payable if there were no dependant's allowance, and if an estate of aggregate net value equal to the dependant's allowance were to pass in whole to that dependant. For this purpose, where the dependant's allowance is less than $50,000, the duty is computed at the rate of 2½ per cent plus 15 per cent surtax. As a result, the maximum reduction for an infirm husband who has a dependent child or for a widow is $4,743.75, for a dependent child $431.25, and for an orphaned dependent child $718.75. If the reduction is not wholly used by one dependant, in some but not all circumstances the reduction may be shared with another dependant. If the property passing to a dependant includes exempt property, such as foreign realty or a $1,200 life annuity, or if the estate is a foreign estate, the dependant's reduction is limited to the proportion thereof that the dutiable property bears to the total property passing to him.

133. In contrast to those found in many other jurisdictions, the Ontario system for making special allowances to the family of the deceased is highly complex. The federal Estate Tax Act allows a basic deduction of $40,000 to all estates, gives further exemptions based on marital status and number of children of the deceased, and taxes the rest of the estate at a rate taken from a single schedule. These

exemptions apply whether or not the widow or dependent children benefit from the estate. The United States allows a basic exemption of $60,000 for all estates, and a deduction of any interest in property which passes to the surviving spouse of up to 50 per cent of the value of the estate. A single rate schedule is used for taxing what remains. In Britain, for estates over the minimum of £4,000, there are no exemptions of a personal nature, and a single rate schedule is applied. We think that a completely new set of exemptions should be introduced into the Ontario legislation to rationalize the provision of preferential treatment. Accordingly, *we recommend that:*

All the present provisions in The Succession Duty Act for giving preferential treatment to relatives and dependants of the deceased be repealed. **28:30**

134. Preferential tax treatment is given to dependent beneficiaries to avoid causing unnecessary hardship for those who relied on the deceased during his lifetime. We believe that the tax should be structured to ensure that there may pass, free of duty to these dependants, an amount which, when wisely invested, would be sufficient to keep them in modest comfort. Once such an amount has been provided for, there is no reason to differentiate between various beneficiaries. It is no part of the purpose of a tax structure to reward or penalize a testator on the distribution he has chosen for his assets, but this is the effect of the present Act by providing for three classes of beneficiaries. Reasonable men leave their estates to those they believe are deserving, and thereby meet whatever obligations they may feel to the extent of their means. It is not for the state to interfere with this very personal apportioning of assets by providing radically different tax consequences for one distribution of an estate as compared to another. In summary, then, once the basic needs of those who are dependent on the deceased have been taken care of, the general principle should be that there be no distinctions between the persons benefiting from the estate, with one exception.

135. We are mindful of general family obligations and of the traditional responsibility most parents feel to leave a legacy to their children, regardless of whether they have left home and become fully independent. As an exception to our general principle, we therefore think that some explicit recognition should be given to this traditional aspect of family relationship.

136. It should be clearly understood that in our recommendations, we are proposing that the exemption apply only to the extent of the gift actually receivable by the beneficiary from the estate of the deceased. If a dependant is left out of the will, the proposed exemptions, unlike the general exemption provided in the federal Estate Tax Act, would not apply.

137. For a widow, we make the assumption that the dependency will last for the rest of her days, although we recognize that many widows find employment or remarry. With this in mind, we suggest that the present dependant's allowance of $75,000 is an appropriate amount for the proposed widow's exemption. Such a sum, if prudently invested, would yield an amount approximating the present

average Canadian wage. We think that this is a suitable criterion to use. In the course of time it will be necessary to review the amount of the exemption to ensure that it is a sum which, if invested at current rates of return, would continue to meet this criterion. Although only one spouse may be the breadwinner, it is true that in most marriages both partners make important contributions to family fortunes, and the dependency of the one upon the other is incalculable. We suggest, therefore, that widowers be given the same exemption as a widow. Accordingly, *we recommend that:*

For succession duty purposes, the widow or widower of the deceased be allowed an exemption of $75,000. **28:31**

138. In our view, it would also be appropriate to give the same exemption as for a spouse to a person who, without pay, has devoted himself or herself for a reasonable period of time to an unmarried, widowed or divorced decedent, or to a decedent whose spouse for some reason did not benefit from his estate. This would apply to a person who lived in a "common-law" relationship with the deceased or to a relative whose major occupation was the care of the deceased. *We recommend that:*

For succession duty purposes, in the absence of an exemption to a spouse, the same exemption as for a spouse be given to a person who, during the five years prior to the death of the deceased, resided with him, was dependent upon him and managed his household without remuneration. **28:32**

139. Usually the period of dependency of children on their parents is limited, but the age at which offspring leave home to become independent members of society varies greatly according to individual circumstances. We recognize the modern tendency, encouraged by government, for children to continue their education for longer periods than was formerly common, so that the home-leaving age is often now in the early twenties. As the age of independence approaches, the need for a large exemption decreases. Accordingly, we suggest that a child under 21 years of age should be allowed an exemption of an amount which, together with interest, would be sufficient to support him during the period of his dependency. For an older child, the exemption should decrease gradually until the age of 25, when most children no longer rely on parents for support and can no longer be classed as dependent children.

140. The exemption allowed for a child 20 years of age or less should be sufficient, as we have said, to provide for his reasonable needs during his period of dependency. We suggest that $25,000 is a suitable amount now for this purpose, although we hope that this figure will be reviewed and changed periodically to keep pace with changes in the cost of living. An exemption of $10,000 should be allowed to a child 25 years of age or more in recognition of the responsibility most parents feel towards their children. Such a figure, we believe, should meet both the desires of parents and the expectations of children. Our proposed exemption

is considerably more generous than the present dependant allowance of $15,000 that generally applies only to a child under 21 years of age.

141. For the age range of 21 to 25 years, the exemption should diminish year by year. To avoid overly complex calculations we suggest that the reduction be structured in five steps of $3,000 each. At the age 21 the exemption would be $22,000, at age 22, $19,000, and so on. This system would also minimize the difference in tax which would occur if the deceased died on or after, rather than just before, the 21st or 25th birthday of a child. Accordingly, *we recommend that:*

For purposes of succession duty, a child of the deceased under 21 years of age at the death of the deceased be allowed an exemption of $25,000, and that an older child of the deceased be allowed an exemption of **28:33**

$22,000 if 21 years of age,
19,000 if 22 years of age,
16,000 if 23 years of age,
13,000 if 24 years of age, and
10,000 if 25 years of age or more.

142. Apart from these general provisions, certain special cases must be considered. Some children, because of infirmity of body or mind, may never achieve financial independence. For these the full $25,000 exemption should be allowed regardless of age. Similar treatment should be given to any others who, although not children of the deceased, were wholly dependent on the deceased and have been treated as such for income tax purposes. *We therefore recommend that:*

For purposes of succession duty, a person be allowed an exemption of $25,000, if he was at the death of the deceased wholly dependent upon the deceased for support by reason of mental or physical infirmity, and in respect of whom the deceased was entitled to a dependant's exemption under the Income Tax Act (Canada) for the taxation year ending with his death and the taxation year preceding that year. **28:34**

143. It is appropriate to allow an increased exemption for a child under 25 years of age who is left with no parents. We suggest that such an orphan child be allowed twice the exemption to which he would otherwise have been entitled, provided that the aggregate increase in the exemptions for him and any other orphan children does not exceed $75,000, the amount that would have passed tax free to his parent had the parent survived the deceased. Thus, if a deceased left four such children each would be entitled to an additional exemption of one quarter of $75,000. *We therefore recommend that:*

For purposes of succession duty, a child of the deceased who has no surviving parent and who had been wholly dependent upon the deceased for support, and in respect of whom the deceased was entitled to a deduction for an exemption under **28:35**

the Income Tax Act (Canada) for the taxation year ending with his death and the taxation year preceding that year, or would have been so entitled if the dependant had then been born, be allowed an additional exemption equal in amount to his normal exemption, provided that if the aggregate of all such additional exemptions to all such children of the deceased would otherwise exceed $75,000, the additional exemption for each such child be reduced proportionately so that the additional exemptions aggregate $75,000.

144. Again, special treatment is appropriate when grandchildren inherit from a grandparent whose deceased child was their parent. In such circumstances each grandchild should share equally with his brothers and sisters the exemption to which his parent, as a child of the deceased, would have been entitled had he lived. This special exemption should be given only if the grandchild was not entitled to any greater exemption under any other provision of the Act. Thus, *we recommend that:*

For purposes of succession duty, a grandchild whose deceased parent was a child of the deceased be allowed the greater of any other exemption to which he may be entitled and the exemption that would have been allowed to his parent had the parent been living and sharing in the estate of the deceased, provided that if there are more than one such grandchildren the exemption that would have been allowed to the parent be divided among all such grandchildren. **28:36**

145. The final refinement in our plan of exemptions is to permit a parent to claim any unused portion of the exemption of his or her dependent children. This will help to avoid any hardship that might be occasioned by the particular distribution of an estate to a widow or widower and dependent children. Accordingly, *we recommend that:*

For purposes of succession duty, the spouse of the deceased be allowed an additional exemption equal to the aggregate of the unused portions of the exemptions to which the spouse's dependent children were entitled. **28:37**

146. Above and beyond these proposed exemptions, which are related to the responsibilities of the deceased and to the needs and reasonable expectations of beneficiaries, we think that there is no justification for providing special treatment for other classes of beneficiaries regardless of their relationship to the deceased or, indeed, their lack of it. All benefits not covered by exemptions should be taxed similarly.

147. There still remains the question of how these exemptions should be treated in the actual calculation of duty. The exemptions that we recommend are

based on the needs of individuals, and pertain to specific beneficiaries. It is inappropriate that all beneficiaries of an estate should benefit from an exemption given to one of them. In our view, an exemption to a beneficiary should not be treated as a deduction in arriving at the aggregate net value of the estate, but should rather be deducted from the portion thereof that is taxable to the beneficiary in arriving at the "net taxable value" of his benefits. *We therefore recommend that:*

> ***For purposes of succession duty, the aggregate of the exemptions allowed to a beneficiary be deductible in computing the* net taxable value *of the benefits received by him but not in computing the* aggregate net value *of the estate.*** **28:38**

148. The present Act does not levy duty on certain small bequests and dispositions. Where all dispositions to any one person do not exceed $500 in value they are not dutiable. In addition, transmissions to any one person not exceeding $500 in value, and property in Ontario passing to any one person not exceeding $500 in value are exempt. Where all the property passing to a person consists of an annuity not exceeding $100, or of an estate or interest for life or a term in any property the yearly income from which does not exceed $100, no duty is levied. Where the aggregate value of all dispositions, transmissions and property in Ontario passing to a person in the employ of the deceased for at least five years prior to the death of the deceased does not execeed $1,000, these are likewise free of duty provided that the employee is classed as a stranger and not as a preferred or collateral beneficiary. We have concluded that there is no valid reason for maintaining any of these exemptions except the exemption for dispositions to any one person that do not exceed $500; this should be integrated with the exemption that we later suggest for the purposes of the proposed gift tax. To achieve this, all dispositions made in any one year to any one person that do not exceed $1,000 should be exempt. *We therefore recommend that:*

> ***For purposes of succession duty, all of the present exemptions in respect of small amounts of property passing and small transmissions and dispositions be abolished and there be enacted an exemption for dispositions made in any one year to any one person that do not exceed $1,000.*** **28:39**

149. At present no estates attract duty if the aggregate net value is less than $10,000. Apart from the administrative convenience of not having to deal with small amounts, once adequate exemptions have been provided, there is no logic in exempting an estate merely because it is small.

150. By departmental practice payment of duty is demanded only if the obligation is $5 or more. Although the administrative costs of handling even small estates no doubt exceeds this small amount, we believe that all taxes which are legally due should be paid. After all, most of the administrative cost is incurred in determining the value of the estate and ascertaining the amount of the tax.

151. The last section of this chapter, dealing with a gift tax, makes certain recommendations about its imposition by Ontario. In keeping with these recommendations, we suggest one further adjusment in the succession duty: a deduction equal to the aggregate of the proposed gift tax exemptions for the three years prior to the death of the deceased. This would provide a deduction of $6,000, which would be subtracted in calculating the aggregate net value of an estate. The $6,000 deduction for dispositions should also be apportioned on some reasonable basis to the various beneficiaries and deducted in computing the net taxable values on which they are liable for duties. Where the total dispositions for all beneficiaries exceed $6,000, it would be reasonable to make the apportionment to each beneficiary in the proportion that the dispositions to him bear to the total dispositions. Where the total dispositions do not exceed $6,000, an amount equal to the dispositions to each beneficiary could be allocated to him, and the remainder apportioned to all beneficiaries in proportion to what their net taxable values would be if the remainder were not so apportioned. In addition to the allocation of the deduction in computing the net taxable value, a credit should be given against the duties for the gift tax paid or payable by the deceased with respect to gifts included in the estate as dispositions. We propose that the credit be applied against the duties to which the recipient of the gift is liable. *We therefore recommend that:*

For purposes of succession duty, **28:40**

(a) a deduction of $6,000 be allowed in computing the aggregate net value of each estate, being an amount equal to the aggregate deduction allowable for gift tax in the three years prior to the death of the deceased;

(b) a deduction be allowed in computing the net taxable value on which a beneficiary is liable for duties of that portion of $6,000 that is reasonably apportionable to him; and

(c) each beneficiary be given a tax credit equal to the amount of gift tax paid or payable by the deceased with respect to gifts made to him by the deceased that are included in the aggregate value of the estate of the deceased.

RATE OF TAX

ONTARIO RATE STRUCTURE

152. The interaction of the present series of rates of duty is complex. A three-part structure, with different rates, applies to the value of all assets received by preferred and collateral beneficiaries. The first part imposes a basic or *initial* rate of duty determined by the *aggregate value* of the estate, which includes the world assets of the deceased whether dutiable or not, a different schedule being used for each class of beneficiary. The second part provides an *additional* rate of duty which also varies depending upon whether the beneficiary is preferred or collateral and which is based on the value of the portion of the estate that accrues

to the particular beneficiary. The two rates are then combined and applied to the amount dutiable against the beneficiary to arrive at his duty. This amount of duty is then increased by a surtax computed at the rate of 15 per cent of the duty for the preferred class and 20 per cent for the collateral class. Only an initial rate of duty based on the aggregate value of the estate applies to the portion of the estate accruing to a stranger. To this duty is added a surtax of 25 per cent.

153. The minimum rate of tax (duty plus surtax) for a preferred beneficiary is 2.875 per cent (assuming his bequest is $50,000 or less and the aggregate value of the estate is between $50,001 and $51,000). The early part of the rate structure has the steepest rise. The rate on an estate of $100,000 passing to a single beneficiary is 8.625 per cent, but over $100,000 the rate of increase slows and is quite uneven. The maximum rate of 33.35 per cent on an estate passing to a single beneficiary is reached at the $5,000,000 level. The lowest collateral rate of tax (duty plus surtax) is 3.0 per cent and occurs when a collateral receives a bequest of from $10,000 to $11,000 from an estate whose aggregate value is $20,000 or less. Rates of tax again climb steeply until 18.24 per cent is reached at $100,000, (assuming the whole estate passes to a single beneficiary) and thereafter the rate of increase is more gradual, though there are numerous variations in the progression of the rates. The maximum rate of 36 per cent is reached at the $3,000,000 level, again when the whole estate passes to a single beneficiary. The lowest stranger rate (duty plus surtax) is 15.625 per cent, levied on bequests of over $10,000 and under $10,800. The general rate of increase is again uneven and a maximum rate of 43.75 per cent is reached at the $800,000 level.

154. It should be realized that the rate arrived at by these calculations is applied to the entire property taken by each beneficiary. Theoretically, there is a point at each rate change where a notch provision would be justified to ensure that the duty on a bequest does not reduce that bequest to an amount less than the after-tax amount of a slightly smaller inheritance that bears a lower rate of duty. Since the rate increases are made by very small steps, the maximum jump would seem to be about $100, this occurs where a beneficiary of the stranger class receives less than $10,000. The method of applying duty has a very real significance for estates just below the first tax rate and for those just over the first tax rate. For example, where a preferred beneficiary receives exactly $50,000 he escapes tax, but if he receives anything over that amount the whole bequest is taxed, including the first $50,000. As a result, a notch provision has been provided for all beneficiaries, but this is applicable only to the first tax rates and not to each succeeding change of rate.

ONTARIO, QUEBEC AND BRITISH COLUMBIA RATE STRUCTURES COMPARED

155. To achieve a reasonably comparable series of rates the following tabulation is based on the assumption that the amount shown is the whole estate and that it passes to a single beneficiary with no deductions for an Ontario dependant's allowance. The Ontario rates include surtax; Quebec has neither a surtax nor a notch provision. The British Columbia rates shown are those prior to the adjust-

ments made in March 1964, which were based on the 50 per cent credit formerly given by the federal government. Accordingly, all three rate structures are reasonably comparable.

Value of estate	*Preferential rate*			*Collateral rate*			*Stranger rate*		
	Ont.	*Que.*	*B.C.*	*Ont.*	*Que.*	*B.C.*	*Ont.*	*Que.*	*B.C.*
$ 10,000.......	nil	nil	nil	nil	5.4%	nil	nil	13.0%	nil
20,000.......	nil	nil	nil	3.1%	7.8	2.3%	16.4%	14.0	12.0%
50,000.......	nil	4.0%	nil	14.3	12.0	11.5	18.8	17.0	14.0
100,000.......	8.6%	8.0	6.5%	18.2	16.0	14.5	21.9	22.0	16.0
200,000.......	10.5	10.0	8.5	20.4	17.7	16.0	25.0	24.5	18.0
500,000.......	14.4	15.5	11.5	24.6	21.7	19.0	34.4	28.3	24.0
800,000.......	18.4	20.0	14.5	28.2	25.7	22.0	43.8	32.0	30.0
1,000,000.......	20.7	23.0	16.0	31.2	28.3	24.0	43.8	34.5	32.0
3,000,000.......	31.1	25.0	24.0	36.0	30.0	28.0	43.8	35.0	32.0
5,000,000.......	33.4	25.0	26.0	36.0	30.0	28.0	43.8	35.0	32.0

CANADA, U.S. AND U.K. RATE STRUCTURES COMPARED

156. In contrast to the rate structure of the three provinces, the Canadian and United States rate structures rise by steps, with the increased rate levied only on the portion of the estate in excess of amounts taxed at lower rates. As a result, the estate always has the benefit of the lower rates and a notch provision is not required, except where the value of a taxable estate is slightly in excess of the general exemption. The Canadian and United States taxes, being estate taxes, are levied against the total taxable value of the estate without the complications of differentiating between different classes of beneficiaries with separate rate structures, which arise in the provincial succession duties. The federal Act provides for varying exemptions depending on the sex of the surviving spouse, the number of dependent children, etc. Canada makes an allowance from its estate taxes for provincial duties, and the United States makes a similar allowance for state taxes. The following table shows the rates before these allowances. In the United Kingdom the maximum rates are applied to the whole estate provided it is in excess of £5,000, subject to a notch provision. No federal tax is payable in Canada on any estate whose aggregate net value does not exceed $50,000. The following is a comparison of the effective rates for Canada, the United States and the United Kingdom, assuming that the Canadian exemption is $40,000, the minimum provided for under the federal Act and the U.S. exemption is $60,000.

*Value of Estate**	*Canadian rate ($40,000 exemption)*	*U.S. rate ($60,000 exemption)*	*U.K. rate (no exemption)*
$ 50,000....	nil	nil	10.0%
100,000....	10.2%	4.8%	21.0
200,000....	16.8	16.4	40.0
500,000....	24.6	25.3	55.0
800,000....	28.9	28.7	60.0
1,000,000....	31.4	30.4	65.0
3,000,000....	44.5	41.0	80.0
5,000,000....	48.3	48.6	80.0

*No adjustments have been made for Canada-U.S. exchange rates; the U.K. pound has been valued at approximately $3.

PROPOSED RATE STRUCTURE

GENERAL CONSIDERATIONS

157. Several issues must be settled in determining the rate structure of a death tax. The first question is whether or not the structure should be progressive. A flat-rate or proportional tax has the charm of simplicity. It also allows individuals to anticipate the amount of tax that will become payable on death more readily than does a progressive structure which must be consulted as the value of a person's assets varies. A proportional flat-rate structure, however, does not meet the requirements we have enunciated as the role for this levy in the tax system of the Province. Given our belief that the over-all tax system should be moderately progressive, our succession duty should be more than proportional to help balance such regressive taxes as the property tax, and this conclusion is reinforced by the fact that income tax, to which it is related, has a progressive rate structure. Further, a progressive death duty will help to ensure an end-of-the-road tax on net capital gains accumulated over a lifetime that under our present progressive income tax structure would otherwise escape tax. Finally, only a progressive tax would help to prevent undue concentrations of wealth from being transmitted by inheritance without at the same time being unduly severe with those of modest fortune.

158. As explained in paragraph 154, the present Ontario rate structure is designed so that the marginal rate is levied on the whole of the inheritance. On the other hand, under the federal Estate Tax Act each successive rate in the schedule applies only to that portion of the aggregate taxable value of the estate that falls within the range for the rate, with the result that the advantage of the lower rates is retained on part of the estate regardless of its size. The structure used by the Ontario statute requires "notch provisions" to prevent estates just above one rate level from being reduced to an after-tax value which is less than that of a smaller estate that is subject to the next lower rate. We think that the type of rate schedule used by the federal government is preferable, since it allows a simple structure to produce a smooth progression in the effective rate of the tax, and avoids the need for notch provisions. Moreover, this is the same type of rate schedule as is used for income tax and is therefore probably widely understood by taxpayers.

OUR PROPOSED RATE SCHEDULE

159. In addition to these general matters of principle, three basic questions must be considered in designing an appropriate rate schedule: what should the lowest rate be; what should the highest rate be; and what should be the degree of progression in the rates?

160. Of these questions, the first is perhaps the easiest to answer. The system of exemptions proposed in the preceding section was designed to eliminate or reduce the duties on persons necessarily dependent upon the deceased. Having provided adequately for the need of the dependants in this manner, we think it is possible to begin the tax at a fairly substantial rate. We suggest that the starting rate should be

approximately the same as the present starting rate (including Old Age Security tax) for taxing personal income: 15 per cent.

161. From the foregoing schedules showing comparative rates of tax in other jurisdictions, it can readily be seen that there is no consistent pattern to the answers that have been given to the question of how high the maximum rate should be. The combined federal and Ontario taxes have a maximum marginal rate of 60.35 per cent for preferred beneficiaries, and 70.75 per cent for strangers. In Britain the top rate is 80 per cent, applied to the whole of any estate valued at more than £1,000,000. Although we support the propriety of government's use of death taxes, we are nevertheless concerned with the effects of very high rates on any meaningful concept of private property. There doubtless comes a point at which reasonable taxation ends and confiscation begins. If the State is thought to be a silent partner in the accumulation and maintenance of wealth, as we have suggested, it should be entitled to a fair share of the capital. In our opinion that fair share probably should not exceed one-half. We claim no magic properties for the figure of 50 per cent, but we do think that it is unreasonable for society to take more than half the wealth of its members as a matter of right under a progressive tax system.

TABLE 28:8

PROPOSED RATES OF BASIC DUTY

Aggregate net value of estate		*Basic duty*		*Average rate on minimum of range (Beneficiaries' rate)*
Not over $25,000........		15%		
Over	*But not over*			
$ 25,000	$ 50,000	$ 3,750 plus 17% on part over	$ 25,000	15.00%
50,000	75,000	8,000 plus 19% on part over	50,000	16.00
75,000	100,000	12,750 plus 21% on part over	75,000	17.00
100,000	125,000	18,000 plus 23% on part over	100,000	18.00
125,000	150,000	23,750 plus 25% on part over	125,000	19.00
150,000	175,000	30,000 plus 27% on part over	150,000	20.00
175,000	200,000	36,750 plus 29% on part over	175,000	21.00
200,000	250,000	44,000 plus 31% on part over	200,000	22.00
250,000	300,000	59,500 plus 33% on part over	250,000	23.80
300,000	350,000	76,000 plus 35% on part over	300,000	25.33
350,000	400,000	93,500 plus 37% on part over	350,000	26.71
400,000	450,000	112,000 plus 39% on part over	400,000	28.00
450,000	500,000	131,500 plus 41% on part over	450,000	29.22
500,000	600,000	152,000 plus 43% on part over	500,000	30.40
600,000	700,000	195,000 plus 45% on part over	600,000	32.50
700,000	800,000	240,000 plus 47% on part over	700,000	34.29
800,000	900,000	287,000 plus 49% on part over	800,000	35.88
900,000	1,000,000	336,000 plus 51% on part over	900,000	37.33
1,000,000	2,000,000	387,000 plus 53% on part over	1,000,000	38.70
2,000,000	—	917,000 plus 55% on part over	2,000,000	45.85

162. We present in Table 28:8 our proposed schedule of rates of *basic duty* rising from 15 per cent to 55 per cent of the portions of the *aggregate net value* of an estate falling within the ranges for the rates. The top rate of 55 per cent applies only to that portion of such value that exceeds $2 million. The average rate

of basic duty on an entire estate would thus in every instance be less than 55 per cent. We propose that each beneficiary's duties be computed by applying the average rate of basic duty on the minimum of the range, determined from the proposed or a similar schedule, to the *net taxable value* of the property passing to him. We have designated this average rate as the "beneficiaries' rate".

163. The proposed rate schedule shows what we term the "basic duty", and not the actual duties that would be payable by the beneficiaries. As already explained, the rate schedule merely provides the means of computing the *beneficiaries' rate* of duty which is then applied to the *net taxable value* of the property passing to each beneficiary so as to determine his actual duties. As the *net taxable value* is determined by deducting the beneficiary's exemptions from the net value of the property passing to him, his actual duties would usually be less than the amounts indicated in the rate schedule. For example, according to the rate schedule the *basic duty* on an estate with an *aggregate net value* of $175,000 would be $36,750, establishing an average or *beneficiaries' rate* of 21 per cent. If the whole estate passed to a widow whose exemptions were $75,000, the actual duties would be $21,000—21% of a *net taxable value* of $100,000. This is considerably less than the basic duty of $36,750 shown in the rate schedule.

164. If the proposed rate schedule were to be applied without modification, the *beneficiaries' rate* would exceed 50 per cent only where the *aggregate net value* of an estate is greater than $3,660,000. In keeping with the view already expressed, we therefore propose that the beneficiaries' rate be limited to 50 per cent. The sharp rise in rates at the beginning of the scale is also in accord with our philosophy of the tax. The State has a proper claim to share in the estate of the deceased, and there is no reason why the proportion taken should not be substantial after adequate provision has been made for a deceased's responsibilities.

165. One further point must be mentioned about the proposed rate schedule. It has been designed on the assumption that it will be the only death tax levied with respect to Ontario estates. If the federal government continues in this tax field, we would recommend a compensating adjustment. For example, if the federal government allows a 75 per cent credit for Ontario duties from its estate tax, Ontario should reduce its duties by 25 per cent in recognition of the federal estate tax.

166. For the reasons explained above, *we recommend that:*

The duties payable by a beneficiary be computed as follows: **28:41**

(a) determine a basic duty by applying a schedule of rates to the aggregate net value of the estate;

(b) determine the beneficiary's rate computed as the average rate of basic duty as a percentage of the aggregate net value of the estate, or 50 per cent, whichever is the lesser;

(c) apply the beneficiary's rate to the net taxable value of the property passing to the beneficiary; and

(d) in the event that the federal estate tax is continued, reduce the resultant amount of Ontario duties by a percentage equivalent to the unabated portion of the federal estate tax.

We further recommend that:

A schedule of rates of basic duty be adopted with rates that are progressively higher for each successive additional portion of aggregate net value ranging from 15 per cent to 55 per cent. 28:42

EFFECT OF PROPOSED RATES

167. In order to show the effect of our proposals on the taxation of estates, we have prepared Table 28:9, to indicate the total amount of tax that would be collected from estates of various sizes, which are distributed in various ways to a variety of beneficiaries. Also shown is the tax that would be due on specific bequests to people who are now classed as "collateral" or "stranger" beneficiaries under the present Ontario Succession Duty Act. For purposes of comparison, we also show the taxes at present payable in like circumstances under the full federal rates, which are applicable in all provinces but Ontario, Quebec and British Columbia, and the combined Ontario duties and federal estate tax as reduced by the present 50 per cent abatement for Ontario duties.

168. We conclude the discussion of our proposed rate structure by demonstrating the computation of the duties payable by the beneficiaries of a hypothetical estate. After taking into account the deductions for debts, funeral expenses, cost of probate, legal fees and the $6,000 basic deduction, our hypothetical estate has an *aggregate net value* of $200,000. Gifts to the widow in the three years prior to the death of the deceased amounted to $6,000, and these were free of gift tax. No other dispositions were made in that period. The will of the deceased provides that the estate be distributed one-half to the widow, and one-eighth to each of a 30-year-old son, a 22-year-old daughter, a close friend and an exempt charity. The duties on the beneficiaries would be computed as follows:

Computation of Beneficiaries' Rate

Aggregate net value	$200,000
Basic duty on $200,000 according to proposed rate schedule	44,000
Beneficiary's rate	
$\frac{44,000}{200,000} \times 100\%$	22%

Computation of Duties

Widow:			
Property passing		$100,000	
Dispositions		6,000	
Aggregate taxable value		106,000	
Deduct: basic deduction	6,000		
exemption	75,000	81,000	
Net taxable value		$ 25,000	
Duty on $25,000 @ 22%			$ 5,500
Son—30 years of age:			
Aggregate taxable value		$ 25,000	
Deduct exemption		10,000	
Net taxable value		$ 15,000	
Duty on $15,000 @ 22%			3,300
Daughter—22 years of age:			
Aggregate taxable value		$ 25,000	
Deduct exemption		19,000	
Net taxable value		$ 6,000	
Duty on $6,000 @ 22%			1,320
Friend:			
Aggregate taxable value		$ 25,000	
Deduct exemption		nil	
Net taxable value		$ 25,000	
Duty on $25,000 @ 22%			5,500
Charity:			
Aggregate taxable value		$ 25,000	
Deduct exemption		25,000	
Net taxable value		nil	
Duty			nil
Total duties payable			$15,620

Each of the above amounts would be reduced by whatever credit is required to compensate for federal estate tax—a reduction of 50 per cent if the present 50 per cent federal abatement continues and a reduction of 25 per cent if the federal abatement is increased to 75 per cent of the estate tax otherwise payable.

169. The above example demonstrates the comparative simplicity of the proposed system. We have eliminated not only the bewildering array of differing complicated rate schedules for each of the preferred, collateral and stranger

TABLE 28:9

COMPARATIVE WEIGHT OF DEATH TAXES: PRESENT CANADA ESTATE TAX, COMBINED PRESENT CANADA AND ONTARIO, AND PROPOSED RATES

		Tax on Whole Estate Based on Estate Division Described										*Tax on a Specific Bequest if deceased has no dependents*			
Aggregate net value of estate (after deduction for debts, expenses, etc. but before exemptions)	*Rate Schedule*	One Preferred Beneficiary not eligible for any dependant or special exemptions		Widow (Without Children)		Widow ½ and one dependent child ½ *or* Life Interest to Widow age 56 (Capital to child)		Widow ½ and two dependent children ¼, *or* Life Interest to Widow age 56 (Capital to Children)		Four dependent children ¼ each (No surviving parent)		$25,000.00 Bequest to a person in collateral (per O.S.D. Act)		$10,000.00 Bequest to a stranger (per O.S.D. Act)	
		Eff. Rate	*Amount of Tax*	*Eff. Rate*	*Amount of Tax*	*Eff. Rate*	*Amount of Tax*	*Eff. Rate*	*Amount of Tax*	*Eff. Rate*	*Amount of Tax*	*Eff. Rate*	*Amount of Tax*	*Eff. Rate*	*Amount of Tax*
$		%	$	%	$	%	$	%	$	%	$	%	$	%	$
	Canada	—	—	—	—	—	—	—	—	—	—	—	—	—	—
50,000	Can, & Ontario	—	—	—	—	—	—	—	—	—	—	14.0	3,495	18.8	1,875
	Proposed	16.0	8,000	—	—	—	—	—	—	—	—	16.0	4,000	16.0	1,600
	Canada	10.2	10,200	6.2	6,200	4.4	4,400	2.6	2,600	—	—	10.2	2,550	10.2	1,020
100,000	Can, & Ontario	13.7	13,725	7.0	6,981	4.6	4,644	2.6	2,600	—	—	22.7	5,670	27.0	2,698
	Proposed	18.0	18,000	4.5	4,500	—	—	—	—	—	—	18.0	4,500	18.0	1,800
	Canada	14.3	21,400	11.2	16,800	9.7	14,600	8.3	12,400	5.5	8,200	14.3	3,568	14.3	1,427
150,000	Can, & Ontario	16.9	25,363	12.2	18,319	8.9	13,350	6.7	10,085	7.1	10,713	25.3	6,328	30.6	3,057
	Proposed	20.0	30,000	10.0	15,000	6.7	10,000	3.3	5,000	—	—	20.0	5,000	20.0	2,000
	Canada	16.8	33,600	14.3	28,600	13.1	26,200	11.9	23,800	9.5	19,000	16.8	4,200	16.8	1,680
200,000	Can, & Ontario	18.9	37,868	15.3	30,624	13.7	27,475	11.5	22,960	10.2	20,425	27.2	6,795	33.4	3,340
	Proposed	22.0	44,000	13.8	27,500	11.0	22,000	8.3	16,500	2.8	5,500	22.0	5,500	22.0	2,200
	Canada	18.7	46,800	16.6	41,400	15.5	38,800	14.5	36,200	12.4	31,000	18.7	4,680	18.7	1,872
250,000	Can, & Ontario	20.4	50,943	17.4	43,499	16.0	40,100	14.8	36,925	14.2	35,596	28.4	7,110	35.9	3,593
	Proposed	23.8	59,500	16.6	41,650	14.3	35,700	11.9	29,750	7.1	17,850	23.8	5,950	23.8	2,380
	Canada	24.6	122,900	23.3	116,300	22.6	113,100	22.0	109,900	20.7	103,500	24.6	6,145	24.6	2,458
500,000	Can, & Ontario	26.7	133,325	25.1	125,321	22.7	113,645	22.0	109,950	21.6	107,812	32.9	8,218	46.7	4,667
	Proposed	30.4	152,000	25.8	129,200	24.3	121,600	22.8	114,000	19.8	98,800	30.4	7,600	30.4	3,040
	Canada	31.4	313,900	30.5	305,300	30.1	301,100	29.7	296,900	28.9	288,500	31.4	7,848	31.4	3,139
1,000,000	Can, & Ontario	36.4	363,950	35.5	354,906	31.8	317,900	30.6	305,739	29.5	294,670	39.3	9,820	59.5	5,945
	Proposed	38.7	387,000	35.8	357,975	34.8	348,300	33.9	338,625	31.9	319,275	38.7	9,675	38.7	3,870
	Canada	39.8	795,700	39.3	785,300	39.0	780,100	38.7	774.900	38.2	764,500	39.8	9,948	39.8	3,979
2,000,000	Can, & Ontario	44.6	892,350	44.1	882,406	41.1	821,875	39.2	784,344	37.4	747,375	43.5	10,868	63.7	6,365
	Proposed	45.9	917,000	44.1	882,612	43.6	871,150	43.0	859,688	41.8	836,763	45.9	11,462	45.9	4,585
	Canada	48.3	2,414,900	48.1	2,404,100	48.0	2,398,200	47.9	2,393,300	47.7	2,382,500	48.3	12,075	48.3	4,830
5,000,000	Can, & Ontario	57.5	2,874,950	57.3	2,864,806	54.4	2,718,000	52.1	2,603,244	49.8	2,489,025	47.7	11,933	67.9	6,790
	Proposed	50.0	2,500,000	49.3	2,462,500	49.0	2,450,000	48.8	2,437,500	48.3	2,412,500	50.0	12,500	50.0	5,000

classes but also the surtaxes. No longer need one wrestle with the almost incomprehensible dependants' allowances and reductions. Yet the differing degrees of responsibility of the deceased to his heirs have been adequately met through straightforward exemptions. Gone are the opportunities for unjustified reductions of duties through leaving the residue of an estate to charity subject to payment of duties on taxable bequests.

SOME ADMINISTRATIVE CONSIDERATIONS

INFORMATION RETURNS

170. The Act requires each person who is to receive any taxable benefit from a decedent or to whom a disposition was made to file an affidavit within three months of the death of the deceased, or such further period as the Treasurer allows. Among other things, this affidavit must contain an inventory of all property passing on the death of the deceased to the deponent and particulars of all dispositions made to him, as well as of all property passing to or for the benefit of others and all dispositions to them of which he has knowledge. In addition, the executors must file a similar affidavit. The time period prescribed is often too short, particularly when a valuation of all assets must be given. In many cases the individual beneficiaries do not know either the value of the assets of the deceased or the value of the bequests to other beneficiaries. The statute also provides that where the executor of the estate has filed the affidavit the Treasurer may dispense with those from the beneficiaries. In practice, however, this flexibility is seldom used and even an executor who is also a beneficiary is required to file two affidavits, one in each of his separate capacities. In our opinion administration would be simplified without jeopardizing the revenue if a beneficiary were required to take an affidavit only in respect of the dispositions made to him and any property passing to him other than under the will of the deceased, such as when the recipient is the beneficiary under a policy of insurance, annuity contract or a pension plan. Only the executor or administrator would be required to include in his affidavit an inventory of all the property passing on the death of the deceased. The affidavit now required of the executor or administrator should be designated the "Succession Duty Return" and this should be filed with the affidavits of the beneficiaries attached except such as may be dispensed with by the Treasurer. The Treasurer would retain his right to require additional information from any source. To allow a more realistic period for valuing assets, the Act should direct that the affidavits be filed on or before the day on which payment of duty is generally required, that is, within six months of the death of the deceased. Accordingly, *we recommend that:*

The present provisions of The Succession Duty Act relating to the filing of affidavits be amended **28:43**

(a) to require a beneficiary to include in his affidavit only particulars of all dispositions made to him and property passing to him or to his benefit other than under the will of the deceased or under The Devolution of Estates Act;

(b) to designate the affidavit of the executor or administrator the "Succession Duty Return"; and

(c) to require the affidavits of the executor or administrator and the beneficiaries to be filed within six months of the death of the deceased.

PAYMENT OF DUTIES

171. Many of the problems of payment arise from the fact that the Ontario tax is a succession duty. The primary liability for payment rests upon the beneficiaries although in practice the deduction and payment of duty is nearly always made by the executor or administrator of the estate.

172. The Succession Duty Act gives effect to the principle that payment of duty is to be made when a beneficiary receives his inheritance. The basic rule is that payments are due six months from the date of death. It has been suggested to us that this time period be extended to one year because at least that length of time elapses before most large estates are ready for distribution to beneficiaries. If the administration of estates is slow, the responsibility rests in good part on lethargic executors and their solicitors who take full advantage of the "executor's year"; we see no reason to reinforce this lassitude. The six-months period should be retained.

173. It is of no consequence under the Act whether the beneficiary receives his benefit from the estate, from an insurance company directly under a contract, or from the deceased in his lifetime as a gift. The obligation under the Act is on the beneficiary to pay his own duties. If the benefit reaches him through the estate, the executor or administrator is subject to penalty if he distributes the benefit without deducting the duty applicable to property passing to him as well as any other duty for which he may be liable. If the benefit comes as a direct payment from an insurance company, that company is subject to penalty if it makes payment without first receiving the consent of the Treasurer of Ontario. If the benefit has reached the beneficiary as an *inter vivos* gift, the Ontario Treasury has no assistance from anyone else in collecting the duty and must look exclusively to the beneficiary to remit the tax payable.

174. By way of contrast, the method of payment under the federal Estate Tax Act is different in theory if not in practice. The executor or administrator is liable for all taxes to the extent that he has assets in his possession. This applies even to insurance paid directly and to an *inter vivos* gift provided the executor holds any asset payable to the beneficiary of the insurance or the gift. The beneficiary is also responsible for payment, but the intention of the Act is to look to and collect from the executor. With some very minor exceptions, all taxes are payable within six months of death.

175. Actually, few executors, even if asked to think about the matter, would distinguish between the effect of their legal obligations under the Ontario Act and under the Estate Tax Act. Their actions are identical in both cases; they pay

over money from the assets in their hands. This uniformity is in part the result of the almost universal practice of Ontario lawyers of including a direction in every will to pay all succession duties out of the residue of the estate. This provision gives the executors legal authority to deal with the duties as if they arose from an estate tax rather than a succession duty, and greatly simplifies the administration of the estate.

176. The Succession Duty Act gives the executor a power of sale but only if the will obligates him to pay the duty out of estate assets. This section has never been interpreted by the Courts, but in any event, at law the executor has implied powers of sale if the will of the deceased imposes an obligation on him to pay succession duties. There is no implied power at law and no provision in the Act to raise funds for duties through the sale of assets where the will does not impose any obligation upon the executor to pay the duties of the beneficiaries. In theory, at least, there can be cases of complete impasse: the executor has no power to raise moneys to pay duties, The Succession Duty Act prohibits him from transferring the asset to the beneficiary and the beneficiary lacks resources. While it is unlikely that such an insoluble case would ever occur, the possibility of its arising should be removed. *We therefore recommend that:*

> ***The executor or administrator of an estate be given specific statutory power to sell all or part of the property included in any bequest to a beneficiary if the beneficiary is unable or unwilling to pay the duties on his bequest.*** 28:44

177. The method of payment is set out in the statute. While payment within six months of death is the general requirement, the duty may be paid in annual instalments if a bequest takes the form of a term or life annuity or a life interest in income. The number of instalments is determined by the term of the annuity or the life expectancy of the beneficiary, as applicable, but in no event may the number of instalments exceed ten. We have discussed these provisions in this chapter in connection with life interests, annuities and pensions, where we have recommended certain changes.

178. If payment to a beneficiary is postponed to a future date, the duties may be postponed until he falls into possession of his "interest in expectancy", but only at the price of paying duties on the value of his interest at that time rather than at the date of the death of the deceased. We discussed this provision in so far as it applies to a remainderman in the portion of this chapter concerned with life interests and interests of remaindermen. There, we concluded that the right of a remainderman to defer payment of duties until the termination of the life interest should be continued for the time being, even though other funds from the estate may be available to him to pay the duties. In our view, the same treatment should be given to other interests in expectancy. *We therefore recommend that:*

> ***The right of the beneficiary of an interest in expectancy to defer payment of duties until he falls into possession be continued.*** 28:45

179. If the duties prove unduly burdensome to the beneficiary there are only two forms of relief provided in the Act. The first is found in Section 23 which gives the Lieutenant Governor in Council discretion to extend the time for payment. The second form of relief is available to the beneficiary who is willing to renounce his benefits under the will—an act that frees him of the obligation to pay duty, but at the drastic cost of giving up his benefits. While we have made recommendations for relief where we think it most needed, these alternatives are required to provide an additional measure of flexibility in some situations.

ASSETS HELD IN SAFETY DEPOSIT BOX

180. The Act prohibits the opening without the Treasurer's written consent of any safety deposit box that stands in the name of the deceased, either alone or jointly with anyone else, or to which the deceased had access although in the name of some other person. In addition, no member of the family of the deceased, including even a relative as remote as an uncle, aunt, or a first cousin of the deceased or of his spouse, is permitted access to his own safety deposit box upon the death of the deceased. This applies even though the deceased had no right of access to that box. This prohibition exists until such time as the contents of the box have been examined by an agent of the Treasurer—a period which may be of several weeks' duration.

181. Any person who opens his box and any person who permits him to do so are both guilty of an offence and on summary conviction liable to a fine of $1,000 plus an amount not exceeding the amount of duty levied on, or in respect of, anything withdrawn from the box. These provisions are so manifestly impractical that neither the Department nor the repositories make any real effort to enforce them against the more remote relatives of the deceased, although the Department might wish to use the power to prosecute where there is a deliberate breach involving the withdrawal from the box of property in which the deceased had an interest or that had been the subject of a disposition by the deceased.

182. The federal Estate Tax Act prohibits the opening of a safety deposit box without the Minister's written consent only where the box was held by or in the name of the deceased, either alone or jointly with another person, or where the box contained property belonging to the deceased or property included in property passing on his death. In our view, even this provision goes beyond what is practical in that a bank or trust company is not privy to the ownership of the contents of a safety deposit box that it rents out, and so should not be liable for prosecution if it inadvertently offends against the prohibition.

183. We have concluded that the prohibition should be restricted to the boxes of the deceased and his spouse, and to those to which they had access, and that a bank or other depository for a safety deposit box should be liable to prosecution only if it permitted opening where it had knowledge of the death of the deceased. We think that, if enacted, such a provision could and should be enforced. *We therefore recommend that:*

The prohibition against opening or permitting the opening of a safety deposit box or other repository be restricted to one that belongs to or stands in the name of the deceased or his spouse, either alone or jointly with another person, or to which either of them had access; and a person who permits the opening of such box or repository without knowledge of the death of the deceased be not liable for prosecution. 28:46

184. The Department has a group of inspectors who examine and list the contents of safety deposit boxes or other repositories before consent is given to deal with them. In smaller centres in Ontario, the manager of the local bank or trust company in which a box is located may be appointed the Treasurer's agent for the purpose of examining the box. Administration of this entire matter would be simplified and accelerated if an officer of each branch office of a financial institution leasing safety deposit boxes were to be deputized to act for the Treasurer without regard to the location of that office. *We therefore recommend that:*

An officer of each branch of a financial institution that leases safety deposit boxes be appointed an agent of the Treasurer for the purpose of examining and listing the contents of any box where the Treasurer's consent to its release is required. 28:47

CONSENT TO TRANSFER

185. Generally no property may be transferred to a beneficiary without a consent from the Provincial Treasurer. Thus, ordinarily, the Treasurer does not require any security for payment, but instead holds back consent to transfer assets sufficient in value to provide protection for any unpaid duties. Statutory authority is given to the Treasurer to accept security for duty. There is, however, nothing in the Act authorizing the Treasurer to *demand* security for duty, and there is also nothing requiring him to issue any consents to transfer before payment of the duties. *We therefore recommend that:*

The Treasurer be required to issue within a specified reasonable time consents to transfer assets when either the duties have been paid or adequate security for payment has been lodged. 28:48

186. The penalties for transferring any property subject to duties without a formal consent are severe. While the imposition of such penalties is generally not to be faulted, the provision of the Act is so broad that it is possible for a person to run innocently afoul of the prohibition through ignorance of the interest of the deceased in the property transferred. *We recommend that:*

Penalties not apply to persons who, with reasonable care, have dealt with assets of the deceased under circumstances 28:49

in which they were unaware of the death or of the beneficial interest of the deceased in such assets.

SECURITY FOR DUTY

187. Security is requested where duty is payable in future instalments. In the case of a life tenant, entitled to receive income from an estate for life, Ontario duties may be paid by as many as ten annual instalments. A problem immediately arises if the life tenant dies before the duties have been paid in full. Who is going to pay the remaining instalments? By the wording of the statute the executors are responsible for the full duties to the extent of the payments they have made to the life tenant even though they have faithfully withheld from these payments the instalments of duty as they fell due. In practice, the Department makes no attempt to collect anything from the executors except the instalments that fell due before the life tenant's death. Under the Act a life tenant, like all beneficiaries, is responsible for paying his own duties. If he has assets, the Department will collect the balance of duties from his estate. If he has no assets, the duties are never collected. Our recommendations concerning the taxation of life tenants and remaindermen will obviate this problem as the executor would deduct the unpaid duty before distributing the assets to the remaindermen beneficiaries in the event that the remaindermen had settled their duties within six months of the death of the deceased; otherwise the Province is in effect compensated through collecting duties on the whole value of the assets then falling into the hands of the remaindermen.

188. The Act permits the Provincial Treasurer to accept security satisfactory to him for the payment of duty under certain circumstances. In practice, before releasing assets of an estate, security is required from an executor or trustee who is an individual in circumstances where none is required from one that is a trust company. While we do not condone this discrimination between different executors, the administrative rules used are flexible, and although there may be some inconvenience, there is seldom any difficulty in substituting securities from time to time to meet the investment requirements of an estate.

PRESERVING FAMILY BUSINESSES

189. It has frequently been argued—though, surprisingly, not in submissions to us—that the present level of death taxes in Canada has resulted in the sale of many Canadian-owned businesses to foreigners. It is true that where a person dies with substantially all of his assets tied up in a closely held business the financing of his death taxes may present a difficult problem. This may be particularly so if the business has been incorporated, because even if funds are available in the company their withdrawal might result in a substantial income tax cost leaving an insufficient amount to pay the death taxes. In such cases the double burden of income tax and death taxes could very well be close to confiscation.

190. When such a difficulty arises it is usually necessary to do one or both of two things: borrow the required funds, or sell part or all of the business or the

shares of the company owning the business. In the event of a sale the buyer might turn out to be a foreigner or a foreign-controlled Canadian corporation.

191. We do not doubt that businesses owned by Canadian families are sometimes expatriated through the need to finance death taxes or to achieve liquidity so that upon death there will be no problem. However, no evidence has been presented to us as to specific instances where this has happened primarily because of the impact of death taxes, and we are inclined to think that other considerations are usually present when a Canadian-owned business is sold to a foreign buyer.

192. Also, we are impressed with the obligation on every citizen to arrange for liquidity requirements in his lifetime if it is his desire that the business be retained in his family. There is ample evidence that such estate planning frequently does take place, and that very often it is when the deceased neglects to do so that the difficulty arises.

193. While the problem of financing death taxes may arise because of the neglect of the deceased, it is nevertheless very real, and must be dealt with. If the duties became payable at a time of tight money, it is conceivable that the successors would be unable to borrow the funds required regardless of the adequacy of their security, and an otherwise unwilling purchaser of their business or shares might have similar difficulty.

194. It was suggested to us that it is in the best interest of Canada that a family-owned business, or the shares in a family-owned company owning a business, be exempt from death taxes. In our view a system of death taxes that allows exemptions for a particular class of property, especially of this magnitude, cannot be supported. Either all property should be taxed, or there should be no tax. For that matter, a parcel of real estate of high value, or a mortgage taken back on a sale, may be just as deserving of an exemption as a family business.

195. The Act now gives the Lieutenant Governor in Council the right to extend the time for payment of duties upon proof to his satisfaction that payment within the statutory time would be unduly onerous. In our view this authority should be transferred to the Treasurer of Ontario. He would thus be in a position to grant a postponement of the payment of duties for a specified period of time on security of the decedent's interest in a family business or in the shares of the company owning the business, with interest at current borrowing rates, subject to such conditions and means of control as he may impose to safeguard the Crown's interest. Such an arrangement should be subject to renewal for a further fixed period if the conditions existing at the time the duties first became due have not improved.

196. It is our opinion that the Treasurer might enlist the aid of the Ontario Development Corporation in judging the merit of an application for postponement, appraising the financial soundness of the business and the adequacy of the security and, in the event of a postponement, making subsequent continuing inspections of the financial position of the business. Of course, such power could also be used

to provide relief in instances where other kinds of property were involved. *We therefore recommend that:*

The statutory authority to allow postponement of duty given to the Lieutenant Governor in Council under Section 23 of The Succession Duty Act be transferred to the Treasurer of Ontario. 28:50

PRIVATE WOODLOTS

197. Representations have been made to us suggesting that succession duties could have the unfortunate effect of forcing the sale of immature timber from woodlots to enable the owners to meet the tax. We know neither how frequent nor how serious an occurrence this may be. It is not for us to advise the government on the needs and methods of forest management and woodlot conservation. If, however, those who do advise the government on these matters are convinced of the need to take steps to mitigate any adverse effects of succession duties, we are prepared to propose a concession.

198. An adaptation of the United Kingdom practice would seem to be the best of several alternatives. In that country the executors or administrators of an estate may choose to defer the payment of tax on woodlots until the trees are sold. To make such a concession a sufficient inducement, it may be necessary to depart from our general principle, and forgo interest on the deferred duty. On the other hand, no deferment should be allowed if there is enough mature timber on the property to pay the tax. Again, to avoid the inconvenience of keeping files open for very small amounts of tax, some minimum should be established below which the tax is fully and immediately payable. To protect the revenue, consent to transfer the wooded property should be withheld until the duties have been paid in full. The goals of conservation could be assured by requiring an agreement to be entered into between the owner and the Department of Lands and Forests ensuring proper management of the plantation and the periodic inspection of it by government officials. This inspection could also provide the information required for a report on the cutting of any timber from the lot. *We recommend that:*

If the government finds that special succession duty treatment is desirable in the interests of woodland conservation, executors and administrators of estates be given the right to elect under specified conditions to pay the duty on timber, based on its value at the time of death, as it is cut or sold. 28:51

ASSESSMENT

199. The procedure for the assessment of Ontario succession duty is perhaps unique. In most cases, the Department issues no assessment or statement of duty at all. Instead, it gives the executors a calculation of the duties, which sets out the assets, the deductions and the allocation of the net estate among the various beneficiaries, as well as the computation of each beneficiary's duties and the times they are payable. Unless an appeal is intended, no formal assessment or statement is

ever issued. If an appeal is intended, it is necessary to request the Department to issue a statement of duty in accordance with Section 34. However, the issuance of this official statement of duty may occasion the greatest time lag in the whole appeal procedure. We are told the delay can be considerable and must seem interminable when the taxpayer wishes to appeal and the Department would be just as pleased if no appeal were taken.

200. When the executor's return is filed, it is reviewed by the Department. In normal circumstances the only intimation the estate representatives receive that no duty is being claimed is their receipt of the Treasurer's consents to transfer all of the assets. No "nil" assessment or statement of duty is issued. It would be a convenience if such a statement were sent, as is done under the federal Estate Tax Act. When duty is payable, the first step taken is to send a letter to the estate representatives asking a number of fairly standard questions designed to elicit additional information that is needed for the calculation of duty. Usually this questionnaire is more detailed and searching than is its counterpart in use by the federal Estate Tax Department. This is understandable, since the amount of duty is based on five criteria: size of estate, value of the benefits received by each individual, relationship of each beneficiary to the deceased, situs of assets, and domicile or residence of the beneficiary.

201. When the benefits conferred by the deceased are definite, the calculation of succession duty can be equally definite. Often, however, the benefits are not capable of determination at the time the duties must be paid, as when the deceased has given his executors power to advance capital to his widow who is the life tenant of his estate. Any such capital payment has the effect of increasing the widow's benefits at the expense of the remaindermen, and the additional rates of duty payable by her (which are based on the size of the individual's benefit) would increase with every significant payment, while the duty payable by the remaindermen would decrease. It should be noted that the increased rate payable by the widow affects not only the duty on the capital sum that has come into her hands by the exercise of the power of encroachment by the executors, but also the duty previously levied in respect of her life interest. The Department places such estates on the contingent record on its own volition where additional duties might be payable, or on request of the representatives of the estate where it might involve a reduction in total duties. The assessor in charge of the estate makes periodic inquiries designed to discover all circumstances that could lead to a reassessment. While we recommend in Chapter 25 that in the absence of fraud or misrepresentation an assessment should be final after a period of six years, an exception should be made in respect of an assessment of duty whenever there has been a subsequent encroachment of capital.

202. While under the Act the duties are levied against each beneficiary, the will of the deceased may provide for the duties to be paid out of the residue of the estate. In this event, a beneficiary benefits both from his bequest and from the payment of his duties by the estate, and he must be assessed duties on both benefits. However, the computation of the duties on the benefit derived from having his duties

paid out of the estate presents a problem. The method adopted by the Act is to charge the same rate of duty as would have been payable had there been no duty exoneration clause. The result is that the duties payable by the residuary beneficiary on the residue remaining after payment of duties, and in respect of the benefit to each beneficiary from the payment of the duties, would be calculated at the same rate as the residuary beneficiary would have been required to pay if the residue had not been reduced by payment of the duties. A more logical approach would be to consider the value of each duty-free bequest to a beneficiary to be the grossed-up amount that after deducting the duties computed thereon would equal the amount of the bequest. However, it is understandable that the mere thought of the horrendous mathematical calculations that would be involved, consequential upon the present complex rate structures, would be sufficient to preclude this logical approach. No such problem exists under the system that we propose, as the rate of duty would be identical for all beneficiaries, including the residuary beneficiary. Whether the benefits of the duty-free bequests were "grossed up" to take into account the payment of the duties from residue or not, the aggregate of the duties receivable by the Province from the estate would be the same.

203. Our proposals would thus facilitate the computation of duties, and enable the issuance of a notice of assessment, including particulars of the computation, as is now done for assessments of federal estate tax. For the reasons given earlier, we think that it is essential that such a notice should be expeditiously provided, whether duties are payable or not, as an automatic procedure of the Department. *We therefore recommend that:*

> ***The statute provide that the Treasurer be required to issue with due dispatch a notice of assessment of duty to each person who benefits from an estate or from dispositions by the deceased, whether duty is payable by him or not, and that a duplicate of each such notice be issued to the executor or administrator of the estate.*** **28:52**

APPEALS

204. The Act sets out the procedure for an appeal from an assessment to the Supreme Court of Ontario. However, three major obstacles have inhibited the launching of appeals, particularly where the amounts of duty involved have not been large:

(1) The taxpayer cannot compel and it is difficult to accelerate, the issuance of a statement of duty, which is a prerequisite to setting the appeal machinery in motion;

(2) there is no sanction on the Treasurer for failure to comply with all the procedural steps; and

(3) the costs of appeal are substantial and a sizeable advance deposit must be lodged with the Court.

These difficulties would be overcome by implementing the recommendation made above as to the issuance of notices of assessment, and our recommendations as to

appeal procedures set out in Chapter 25, in which we discuss in detail appeal provisions for all provincial revenue statutes.

205. We have recommended that the executor and each beneficiary receive a notice of assessment. Anyone who receives a notice of assessment should have a right to commence an appeal. The Revenue Appeal Board and the Supreme Court, however, should consider whether in the circumstances of any particular appeal other persons interested as beneficiaries or executors should properly be given notice of the proceedings.

FOREIGN ESTATES

206. Difficulties and complexities are compounded when the assessment is in respect of beneficiaries of foreign estates. As we have previously explained, Ontario levies duties on property in Ontario owned by a non-domiciliary, as well as all dispositions of property, other than of realty outside Ontario, made by a non-domiciliary to any person who at the date of the death of the deceased was resident in Ontario, or to any person not resident in Ontario at that date if the property was in Ontario at that date and was owned by him or a business or company in which he had an interest and to which he had transferred the property for less than full consideration. To compute the Ontario duties, the Department requires information not only about the property and dispositions on which duty is levied in Ontario, but also about all other property of the deceased outside Ontario. The aggregate value of his world assets, less debts and other deductions allowed under the Ontario Act, as well as the portion thereof distributable to each beneficiary, must be determined in order to ascertain the rates applicable to each beneficiary on the Ontario property and dispositions. As information with regard to foreign assets and debts is not readily available to the assessor, it is a difficult and time-consuming task to make an assessment and, when made, it is equally difficult and sometimes virtually impossible for a taxpayer to check the assessment from the information set out in the statement of duty.

207. Foreign investors who become aware of this onerous procedure and the uncertainty of the amount of Ontario duties are often discouraged from investing in the province, particularly when it is neither convenient nor practical for them to avoid the duty by incorporating a personal holding company. A common example is a resident of the United States who has a summer cottage in the province or small investments in Ontario mining stocks. On his death, it is necessary to disclose his entire estate to the Ontario authorities. On the other hand, the assessor has the impossible task of trying to verify the completeness of the assets disclosed and the accuracy of their valuation. In our opinion, the method of taxing assets in Ontario owned by deceased persons who were neither domiciled nor resident in Ontario at their death should be simplified to remove this barrier to investment in the province.

208. The federal Estate Tax Act resolves this problem by charging a flat 15 per cent tax on the value of all assets in Canada owned by foreign estates. Simple

though this remedy may be, it does not conform to the recommendations we have made in this chapter. If it is proper to tax Ontario citizens on the basis of graduated rates, it is neither logical nor equitable to tax foreigners differently. Therefore, rather than adopting a flat rate we propose that the same rate schedule apply as for Ontario estates, but that the *beneficiary's rate* be determined by reference to the *aggregate net value* of only such property and dispositions as are subject to duty in Ontario. We propose further that no exemptions be allowed, so that the rate would apply to the full *aggregate net value.* Thus the tax calculation for foreign investors would be greatly simplified. Where the Ontario assets and dispositions of a foreign estate are small, the application of the *beneficiary's rate* without benefit of exemptions might impose a harsh levy. Therefore, we would permit the executor or administrator of a foreign estate to elect to file in the same manner as for a domestic estate. In this event the *beneficiary's rate* would be calculated by reference to the *aggregate net value* of the entire estate, and the rate would be applied to the *net taxable values* after exemptions of Ontario property and dispositions assessable against the various beneficiaries. Where a beneficiary also receives benefits from foreign property not taxable in Ontario, we think that it would not be appropriate to allow the full normal exemption. We suggest, therefore, that where the deceased was neither domiciled nor resident in Ontario, the exemption given to any beneficiary be the proportion of the normal exemption that the value of Ontario property and dispositions taxable to him is of the total value of all property and dispositions by which he benefited. *We therefore recommend that:*

> ***A beneficiary subject to duties on Ontario property and dispositions from a deceased who was neither domiciled nor resident in Ontario be assessed duties on the aggregate net value thereof without reduction for exemptions, unless all such beneficiaries and the executor or administrator of the estate elect that duties be computed in the ordinary manner, in which event the exemptions for each beneficiary be the proportion of the normal exemptions that the aggregate net value of property and dispositions dutiable to him in Ontario is of the aggregate net value of all property and dispositions by which he benefited.*** 28:53

209. It has been drawn to our attention that dividends declared but not paid prior to the death of a non-domiciliary or non-resident of Ontario are at present subject to duty. This practice, while legally correct, is doubtless an unnecessary irritant to foreign investors in Ontario companies, and could well be discontinued with the loss of only a very small amount of revenue. *We therefore recommend that:*

> ***All dividends having an Ontario situs declared but not paid prior to the death of a deceased who was neither domiciled nor resident in Ontario be exempt from succession duties.*** 28:54

GIFT TAX

210. The federal government has, since 1935, levied a tax under the Income Tax Act on gifts made by resident individuals and personal corporations, whether directly or through transactions by which they confer benefits on persons with whom they are not dealing at arm's length. Corporations, other than personal corporations, are not taxable. The Act requires that tax be paid on gifts made in any year by April 30 of the following year.

211. The provisions of the tax are fairly simple. Gifts made by a donor during the year to any one individual not exceeding $1,000 in total are exempt and need not be declared. Gifts to charitable organizations or trusts, or to any government in Canada are also exempt. Taxable gifts (i.e., gifts not specifically exempt) made in the year by a personal corporation are subject to a general exemption of $4,000; taxable gifts made by an individual in the year are subject to a general exemption of the greater of $4,000 or one-half the difference between the donor's taxable income for the previous year and the federal tax paid thereon. A further "once-in-a-lifetime" exemption of $10,000 is allowed in respect of a gift between husband and wife of an interest in real property to be used as their residence, or a gift to the donor's child of real property to be used for farming by the child alone or with the donor.

212. The tax is levied on the aggregate taxable value of the gifts—that is, the total amount of taxable gifts less the general exemption and, if applicable, the once-in-a-lifetime exemption. To this aggregate taxable value, a rate is applied that ranges from 10 per cent where the amount is $5,000 or less, to 28 per cent where the amount is $1,000,000 or more. The rate applies to the whole of the taxable value without the benefit of any notch provisions. Filing a gift tax return is not obligatory, unless the total amount of the taxable gifts made in the year exceeds the exemption, but there are penalty provisions for failure to file a return when the tax is due. The donor is made primarily liable for the tax, but if he fails to pay, the donor and the donee become jointly and severally liable.

213. If death occurs within three years of making a gift, the federal Estate Tax Act brings in the amount of the gifts for estate tax purposes, but allows a credit against estate tax of the amount of federal gift tax paid on these gifts. The Ontario Succession Duty Act taxes gifts made within five years of death but, as would be expected, does not allow any credit against duties for federal gift tax.

214. The federal gift tax was designed to discourage transfers of assets within a family that would have the effect of reducing the over-all amount of income taxes paid by the family; hence its location in the Income Tax Act. There is considerable evidence that this provision has helped to preserve the income tax revenue. While a gift tax was imposed before the federal government entered the succession duty field in 1941, we nevertheless believe that it has proved to be even more important in preserving the base for death taxes. There is no doubt that a large proportion of gifts are made with a view to reducing death duties. It follows, then, that a gift tax should be levied by those jurisdictions that impose some form of death tax, and that the gift tax should be so constituted that it is complementary to the death

tax. Accordingly, we are of the opinion that Ontario should enter the gift tax field with the objective not of raising revenue but of preserving the revenue from the succession duty.

215. As far as possible, Ontario's gift tax should parallel the provisions of the succession duty that we recommend. This means that the rates of tax and the method of calculation should be the same. It would also require the same methods of valuation. It must be recognized that this would increase quite substantially the taxes now applicable to gifts. On the other hand, an individual would still be able to distribute his assets over a period of years and attract less tax than under succession duty, simply because tax would be calculated annually at the comparatively lower rates applicable to the part of his estate that is disposed of in each year. This advantage to the taxpayer would be partially offset by the necessity of having to pay tax before it would otherwise have come due as a death duty. Gifts made within three years of death, together with the tax paid on them, would be brought into the aggregate net value of the estate, and a credit allowed against succession duty for the amount of provincial gift tax paid in respect of such gifts. This tax, then, may usefully be thought of as a discounted prepayment of succession duty.

216. We believe that the exemption from the present federal gift tax is too high. We know that this generous exemption in an aggressive estate plan allows a large amount of property to be given away over a period of years, and can seriously erode the base of the succession duty. We are unable to find any justification whatever for the optional exemption of one-half of the taxpayer's income of the previous year after deducting the amount of tax paid thereon. We recognize that the tax is not intended to bring into its ambit casual gifts of unimportant amounts that are made beween members of a family throughout the year and that an exemption should be provided to reflect this intention.

217. To limit the tax to substantial gifts, those made to any one person during the year that amount in the aggregate to not more than $1,000 should continue to pass free of tax as under the federal Act. A further $2,000 should be allowed each year in recognition of the fact that certain substantial gifts may be a regular part of the mode of living of many people. A larger exemption than this would, however, reduce the effectiveness of the tax in preserving the revenue from succession duty. It is also necessary to consider the combined effect of our proposal to adopt the "ownership" test for taxability of life insurance proceeds and of the gift tax exemption of $2,000 a year that we propose. A sizeable policy of life insurance can be purchased and paid out of gifts of $2,000 each year, thereby significantly decreasing the tax base for the succession duty without any corresponding payment of gift tax. We therefore propose to exclude both from the specific exemption for gifts to individuals not exceeding $1,000 and from the additional general exemption of $2,000 any gifts used directly or indirectly to pay life insurance premiums on the life of the donor. Finally, gifts to Canadian charitable organizations or to any government in Canada should continue to be exempt.

218. The rate of tax should be determined by reference to the aggregate value of gifts for the year. This would be the total of all gifts made during the year,

including gifts to any one charitable organization that exceed $1,000 in the aggregate, but excluding gifts to governments and gifts to any one individual or to any one charitable organization that in the aggregate do not exceed $1,000. The tax at the rate determined as above would be computed on the "net taxable value" of the gifts, which would be the aggregate value less the portion thereof represented by gifts to charity and less the annual exemption of $2,000. This would bring the calculation of gift tax into conformity with our proposal for succession duties.

219. Our recommendations for succession duties take into account the proposed $2,000 annual exemption for gift taxes. There we recommend that, in computing the aggregate net value of the deceased's estate, gifts and other dispositions made in the three years prior to death be included and the amount of $6,000 —the equivalent of the proposed gift tax exemptions for the three years prior to death—be deducted.

220. Primary responsibility for paying the gift tax should rest on the donor, but where the donor fails to pay it, the donor and the donee should be jointly and severally liable. We think that the enforcement of the tax would be materially improved if both the donor and the donee were required to report gifts annually. Filing an annual return showing taxable gifts both given and received would then be an obligation of all taxpayers. This would mean that charitable organizations would be required to report gifts in excess of $1,000 received in the year from any one donor resident in Ontario.

221. We have already suggested that the federal government should be urged to withdraw from the death tax field. Because gift tax is more closely related to death duties than to any other levy, representations should be made to that government to withdraw from the gift tax field as well. We recognize, however, that gift tax is useful for income tax purposes, and that the federal authorities may want to retain the tax for this reason. If the federal government remains in the field, Ontario should press for a 75 per cent abatement of gift tax—the same as is in effect given on estate tax, at the present time.

222. Because the federal government is ideally situated to administer gift tax for the provinces as well as itself, we are loath to suggest the establishment by Ontario of a separate organization for this purpose. On the other hand, we would not expect the federal government to collect an Ontario gift tax unless it remained in the field and the base for the Ontario tax were identical with that of the federal tax. In the event that the federal government remains in the gift tax field, Ontario should try to persuade it to change the federal tax base to that which we propose. If this fails, Ontario must collect its own tax. In our view, the advantages to be gained by a provincial gift tax are sufficient to justify establishing a separate collection organization. Accordingly, *we recommend that:*

Ontario introduce a gift tax applicable to individuals and personal corporations with the same rate structure as recommended for succession duties, and that: **28:55**

(a) a gift to any government in Canada be exempt;

(b) gifts to recognized charitable, educational or religious organizations be exempt;

(c) gifts made by an individual in the year to any one person not exceeding $1,000 in the aggregate be exempt;

(d) a general exemption of $2,000 be allowed each year to an individual with respect to otherwise taxable gifts;

(e) gifts used directly or indirectly to pay a premium on any contract of insurance on the life of the donor be excepted from the exemptions in (c) or (d) above; and

(f) gifts that would be exempt under (d) and gifts exceeding $1,000 in the year to any one organization that would be exempt under (b) be included in the aggregate value for purposes of determining the rate of taxation, but be excluded from the net taxable value subject to the tax.

FEDERAL-PROVINCIAL SHARING OF DEATH TAXES

223. Until 1941 the provincial governments were alone in the death tax field in Canada. In that year the federal government imposed a succession duty which was replaced in 1959 by an estate tax. The original purpose of the federal duty was to raise revenue, but now that 75 per cent of the yield from the estate tax is diverted to the provinces it would appear that this is no longer the important reason for continued federal occupation of the death tax field. By agreement with the provinces, Canada now keeps only 25 per cent of the revenue that would be collected from levying its full estate tax. The actual agreements vary. For most provinces the full federal estate tax is collected and 75 per cent of the proceeds is remitted to the provincial governments. From Ontario estates, Canada collects only 50 per cent of the full federal tax, the other 50 per cent being abated in recognition of the succession duty levied by Ontario, and it then pays to Ontario one-half of the 50 per cent that it does collect. The result of these agreements is that the estate tax now constitutes a very small fraction of federal revenues.

224. Ontario, Quebec and British Columbia, the three most populous provinces in Canada, levy their own succession duties. Estates assessed in these three provinces in the year ended March 31, 1965, provided over $58 million or some 77 per cent of the total tax of nearly $76 million assessed against Canadian estates.[10] But the estates yielding the bulk of this revenue must in any event be processed by provincial succession duty administrations which, with a minimum of extra effort, could have collected the portion retained by the federal treasury. In effect then, the Government of Canada provides an administration to collect a very small

[10]Department of National Revenue, *1965 Taxation Statistics*, Part Two, p. 82.

amount of estate tax each year, most of the costs of which are incurred in connection with estates in provinces that have their own administration. This is a needless and extravagant duplication.

225. It has been maintained, with some merit, that the estate tax is necessary in order to protect the integrity of the personal income tax, which Ottawa administers throughout the country. Certainly the opportunity that income tax administrators have to look for unreported incomes of deceased taxpayers and to collect the tax is lost once estates are distributed to their beneficiaries. To achieve this collection advantage, however, it is not necessary for the federal government to administer its own death tax. We believe that this is an area where closer co-operation between the federal and provincial levels of government is not only possible, but also desirable. Provincial governments could, and should, make their succession duty files available for inspection by federal income tax officials. The federal income tax revenue could be protected by requiring a copy of each provincial succession duty return to be filed with the Minister of National Revenue, and requiring the executor or administrator of an estate to obtain an income tax clearance certificate before distributing the assets of the estate. The result would be an equally effective administration for both death and income taxes, and a considerable over-all saving in administrative costs in this country. *We therefore recommend that:*

Ontario make representations to the Government of Canada to withdraw from the death tax field on the understanding that Ontario succession duty returns and files would be made available to federal officials for income tax purposes. **28:56**

226. We realize that the federal government might not wish to withdraw from the field unless all the provinces who desired revenue from death taxes imposed their own succession duties. Also it might be thought that tax-haven competition between the provinces would be discouraged by leaving the federal statute in effect, subject to a collection agreement with any province that levies an acceptable death tax. At the very least, Ontario should press for uniform succession duty Acts for the federal government and the three provinces that now levy their own duties. This would permit the federal government to rely on the three provincial administrations to assess and collect the federal tax on an agency basis, thereby permitting a reduction in the federal staff necessary to assess and collect the taxes on estates in the remaining provinces, which do not levy such taxes. If both Quebec and Ontario enact uniform succession duty statutes (and the Quebec Royal Commission on Taxation has recommended a structure for Quebec similar to the one we suggest for Ontario) it would be most unfortunate if the federal and British Columbia authorities were not prepared to enact parallel succession duty statutes.

Chapter 29

The Retail Sales Tax

INTRODUCTION

1. The introduction of a general expenditure tax in September of 1961 utilized the only large, untapped source of tax revenue remaining to Ontario. The decision was taken in the light of the sharp and continuing upward trend in the level of provincial post-war expenditures, a subject discussed at some length in Chapter 4 of this Report. It would nevertheless be wrong to assess the use of this tax solely in terms of expediency. In fact, it represented a necessary addition to the Ontario revenue system if that system was to be as balanced and equitable as possible.

2. The generally accepted economic and philosophical arguments advanced in support of the sales tax may be summarized as follows:

(a) Expenditures on goods and services are one measure of ability to pay. Hence taxes on expenditures can improve the equity of the whole tax system, provided the structure of such taxes includes appropriate exemptions.

(b) Although all citizens benefit substantially from government expenditures, many individuals contribute little or no revenue to government through

taxes on income or wealth. These individuals should be made aware of the costs of government and be asked to contribute in some degree to the bearing of such costs through an expenditure tax.

(c) The inherently detrimental economic effects of expenditure taxes are less pronounced than those associated with many other forms of taxation.

3. Before analysing the present Ontario Retail Sales Tax, we shall consider three general forms of expenditure taxes: the turnover tax, the value-added tax, and the single-stage sales tax.

COMPARISON OF EXPENDITURE TAXES

TURNOVER TAX

4. The turnover tax, used in many European countries, notably Germany, is the most rudimentary of the three taxes here discussed and, in our opinion, the least defensible. The turnover tax is a tax payable (a) on gross receipts from sales of all goods and services, including previously paid turnover tax passed on in prices, (b) on consumption of their own produce by producers, and (c) on sale or licensing of a patent or similar right. The tax is thus levied cumulatively each time goods change hands.

5. The turnover tax may be criticized on grounds of both equity and administrative complexity. It applies to all production goods, materials, machinery and equipment at each stage of exchange or transfer from manufacturer to distributor, to wholesaler, to retailer, to ultimate consumer. It results in what European tax writers call the "cascade effect", or what in Canada has been called tax pyramiding. Tax is piled on tax, layer after layer, with the greatest weight at the retail level, the base of the pyramid. To obtain the same yield as our present sales tax, the rates of tax can be much lower because the tax is pyramided. However, such a tax clearly bears most heavily upon those goods whose stages of production and distribution are not well integrated within one or a few units of ownership. While it would be difficult for most manufacturers to integrate fully the distribution of their goods to the ultimate consumer, the adoption of the turnover tax would provide a strong incentive for such integration. Because of the comprehensive nature of this tax, its use gives rise to strong pressures on government to grant a host of exemptions from or exceptions to its application in particular circumstances. In this connection, the exemption of goods produced for export is a common example.

6. For these and other reasons, we think that a turnover tax is quite unsuitable for use in Ontario. If a wholesaler within this province were taxable, while wholesalers outside the province were not subject to such a tax in their own jurisdictions, retailers would, where possible, switch their buying to wholesalers outside. Similarly, retailers outside the province who purchased from a wholesaler in the province would, if possible, shift their buying to another province. Furthermore, a manufacturer in Ontario selling all his goods outside the province would be collecting tax from persons who owe no allegiance to Ontario. Finally, since this type of consumption tax is largely indirect, a province wishing to adopt it would first be

required to seek a constitutional amendment. For all of these reasons, we reject this type of expenditure tax.

VALUE-ADDED TAX

7. The value-added tax was developed in France and its use together with the French local sales tax and the service tax means that (as with the German turnover tax) almost every person in business in France is a tax collector. As with the turnover tax, this poses serious administrative problems. The value-added tax is multi-stage, but unlike the turnover tax it is not cumulative. Because of this particular advantage over the turnover tax, the value-added tax has recently enjoyed an acclaim far beyond its just deserts. In an excellent article entitled "Requiem for T.V.A.",[1] the *Economist* of March 14, 1964, reports the findings of the United Kingdom's Richardson Committee. In comparing the value-added tax with the British purchase tax, the Committee states that: "It would not assist exports or growth and would involve a far greater administrative burden both for business and for the tax authorities." The article points out that a T.V.A. would have 277,000 collection points while the British purchase tax has only 65,000. The basic purpose of the two taxes was the same, namely "to tax consumer expenditure".

8. Many of the objections relating to the turnover tax would likewise apply to the value-added tax, although the pyramiding effect of the former would not be present. Rather, the opposite kind of problem might exist, in that the full retail value of a good would be taxed only if its entire process of production had taken place within the province. This is so because at each stage of production tax is paid only on the amount of value added to the product at that stage. Thus, for example, the retailer at the end of the process pays tax only on his *mark-up* on the price he has paid for the article—that is to say, on the amount that he has added to its market value. For all articles sold in the province but manufactured outside, the tax proceeds would consist only of the tax rate applied to *distribution* costs incurred in Ontario. A higher rate to produce more revenue would merely increase the tax differential between similar goods, some of which were manufactured entirely in Ontario while others were manufactured in whole or in part outside the province. The value-added tax appears to have no obvious advantages over a single-stage tax at the retail level. Moreover, its use would require a constitutional amendment before Ontario could impose it.

SINGLE-STAGE SALES TAX

9. Expenditure taxes on this continent and in the United Kingdom have traditionally been confined to single-stage taxes primarily on consumer goods and, in some instances, on services. The tax may be levied directly on the manufacturer, as the federal sales tax is in Canada. Alternatively, it may be imposed on retailers, as is done in many states of the United States. Again, the levy may be imposed on the purchaser with the retailer nevertheless liable for the payment of the tax, as in the United Kingdom. Or, finally, the tax may be placed directly on the

[1] T.V.A.: Tax on value added.

ultimate consumer, as it is in the provinces of Canada and many states of the United States. All these varieties of the single-stage tax, as well as special excise taxes, are generally designated, in Canada as elsewhere, sales taxes.

10. Although sales taxes in Canada are single-stage taxes, not all are imposed on the final consumers or purchasers of the taxed goods. This is obvious, of course, where the tax is imposed (as the Canadian federal sales tax is) at an intermediate stage of production. It is also true where it is imposed at what appears to be the final stage of production, but on goods that are used in the production of other goods (e.g., on trucks, building materials, machinery, computers, etc.). We argue elsewhere in this chapter that in so far as is administratively feasible, such capital goods should be exempted from sales tax. Where a sales tax is applied initially to other than final consumers, it is likely to be shifted forward with a consequent undesirable pyramiding effect. Both federal and provincial sales taxes are generally levied on consumer goods, and a wide range of foodstuffs is exempted along with other items of a politically sensitive nature. Thus Bibles and soap may be exempted to avoid taxing godliness and the next ranking virtue, cleanliness. For constitutional reasons, the Canadian provinces may not impose sales taxes on the seller of goods. The Ontario retail sales tax is therefore imposed directly at the retail level on the consumer or user of tangible personal property in Ontario. This tax is payable to the vendor, as agent for the Province, at the time of purchase by the consumer.

HISTORY OF SALES TAXES IN CANADA

11. The first retail sales tax in Canada was introduced by the City of Montreal on May 1, 1935, mainly to meet heavy relief payments which jeopardized the balanced budget required by statute. The rate of tax was 2 per cent, and it applied to all retail sales of tangible personal property except certain goods bought by manufacturers, and food.

12. The first provincial sales tax was introduced by Alberta on May 1, 1936, as a result of requests from municipalities for the Province to assume a larger share of education and social costs. The rate of tax was also 2 per cent, and was originally intended to apply to a very broad base, exempting only bread, milk and a few other necessities. Before the tax became effective, however, political pressures effected the exemption of drugs, most foods, meals, textbooks and sundry other items. The tax proved to be very unpopular and it was repealed on August 6, 1937. It has not subsequently been reintroduced.

13. Saskatchewan introduced a sales tax on August 2, 1937, as part of its effort to overcome a drastic decline in provincial revenues and a rapid increase in relief rolls occasioned by the catastrophic economic effects of both drought and depression. The rate was set at 2 per cent and applied to the sale of all goods, with the exception of certain foods, services and farm implements. The tax became a permanent addition to the revenue sources of the Province, with rate increases to 3 per cent in 1950 and 5 per cent in 1962 and a reduction to 4 per cent in 1965.

14. With the sales tax firmly established in one province, most of the other provinces followed a similar course, to help in the financing of their rising expenditures. Quebec was the second province to introduce a lasting retail sales tax; this became effective on July 1, 1940, at a rate of 2 per cent. The Montreal sales tax continued, but was administered by the Province. Numerous other Quebec municipalities introduced sales taxes of their own, also at the rate of 2 per cent. In 1961, the Quebec provincial rate was raised to 4 per cent, and in 1964 the Province took over the whole sales tax field, with the result that a uniform rate of 6 per cent now applies to the entire province, the municipalities receiving allocations from the Province. It was announced in the 1967 Budget that effective March 17, 1967, the rate would be increased to 8 per cent.

15. British Columbia entered the retail sales tax field on July 1, 1948, New Brunswick on June 1, 1950, and Newfoundland on November 15, 1950. These respective rates were 3 per cent, 4 per cent and 3 per cent. All three provinces have kept the sales tax as part of their revenue structures. British Columbia in 1954 increased its rate of tax from 3 per cent to 5 per cent, New Brunswick reduced its rate from 4 per cent to 3 per cent in 1954 but increased it to 6 per cent on January 1, 1967, and Newfoundland increased its rate in 1960 from 3 per cent to 5 per cent and in 1967 to 6 per cent.

16. In the wake of the national hospital insurance plan and the continuing rise of government expenditure, two more provinces, Nova Scotia and Prince Edward Island, imposed retail sales taxes at the close of the 1950's. Nova Scotia introduced a 3 per cent tax on January 1, 1959; Prince Edward Island followed with a 4 per cent tax on July 1, 1960. Both provinces have since raised their rates to 5 per cent.

17. That Ontario was able to defer the introduction of a sales tax until recently was due in part to the greater productivity of its other sources of revenue. But the rising costs of new hospital services and of the Province's responsibilities in education, coupled with the refusal of the federal government to grant greater income tax abatements requested by Ontario, led the Province to its decision to adopt a retail sales tax. The announcement was made by the Honourable James N. Allan, Treasurer of Ontario, on March 9, 1961, in the annual Budget Statement. The rate of tax was 3 per cent, effective from September 1, 1961. This rate was increased to 5 per cent on April 1, 1966.

18. On December 1, 1964, Manitoba introduced a selective 5 per cent sales tax called a "revenue tax". The tax was levied on fuel, coal and its derivatives, steam and hot water heating, electricity, local telephone charges, long distance telephone charges within the province, and natural and manufactured gas. This tax was thus a highly selective sales tax, unlike those of all the other provinces that utilize this source of revenue. It was announced on February 6, 1967, that a 5 per cent general retail sales tax on tangible personal property and services, with exemptions for food, children's clothing, manufacturers' goods, and a long list of other items, would be effective June 1, 1967. The only province that has avoided the introduction of a sales tax is Alberta.

THE ONTARIO RETAIL SALES TAX AS A SOURCE OF REVENUE

19. The retail sales tax has been among the top four revenue producers of the Province during all of the four fiscal years ended in 1963 to 1966. With the increase in its rate from 3 per cent to 5 per cent, in the 1967 fiscal year it is expected to yield only slightly less than the personal income tax received under the Income Tax Collection Agreement with the federal government. The revenue for the fiscal year ended March 31, 1963, was $175,714,557; for 1964, $186,534,521; for 1965, $195,298,715; and for 1966, $220,998,196. In 1966, each percentage point of the 3 per cent tax yielded $73,666,065. The Treasurer of Ontario in his 1967 Budget Statement estimated a yield of $387 million in 1967 from the new 5 per cent tax. For 1968 the tax is expected to provide $412 million.

20. The yield of the retail sales tax is relatively stable, when compared with those of many other taxes that are more affected by prevailing economic conditions. Although in time of recession there may be a reduction in purchases of such consumer durables as automobiles and household furnishings, purchases of staples such as clothing and household supplies continue to provide a reasonably stable revenue. Because of the heavy reliance placed upon the tax in our revenue system, a full appreciation of its fundamental characteristics, including its economic and social effects, is of the utmost importance.

GENERAL ANALYSIS OF ONTARIO RETAIL SALES TAX

WHO PAYS RETAIL SALES TAX

21. The traditional assumption is that sales taxes are borne in very large part by ultimate consumers, in the form of higher prices occasioned by the imposition of the tax. Thus the tax burden is measured by the income surrendered to the government by the buyers of the taxed items. Because many of the exemptions associated with sales taxes can be justified only if the burden in fact does fall on consumers, we shall consider the main factors that affect the incidence and hence the economic consequences of this tax. We shall also note briefly the effects of sales tax exemptions on the distribution of income within the economy.

22. Constitutional considerations require that provincial sales taxes in Canada be legally levied on *consumers*. The vendors of taxable goods are thus merely tax collectors. They are required to collect the tax on each sale of goods to an ultimate consumer and are prohibited from quoting prices that include the tax. It is nevertheless possible that, upon the introduction of a retail sales tax, a vendor may reduce his pre-tax selling price, thereby absorbing a part of the tax burden. Alternatively, or additionally, he might attempt to lower amounts paid to his employees or suppliers, thereby shifting a part of the burden to them. In fact, the incidence of the sales tax depends upon numerous factors, among the most important of which are (a) the breadth of the base of the tax, (b) the supply and demand conditions in the market for the particular taxed item and in the markets for the labour and other resources required in its production, (c) the length of the period analysed during which price and wage adjustments could be made and

(d) the particular monetary and fiscal policies pursued by the federal and provincial governments.[2]

23. In examining briefly each of these influences, it is possible to view the Ontario retail sales tax either as a collection of individual excise taxes levied at the same rate or as one general tax on all consumption expenditures. It therefore seems useful to examine first the incidence of a specific excise tax and then of a broadly based general sales tax.

24. If an excise tax is placed on a commodity produced by firms that are prevented by competition from controlling its price, the price will likely increase immediately by some part of the tax, but most of the tax will be borne by the firms. As a result of the increase in price, consumers will buy less of the taxed commodity. The sellers of the taxed product will then reduce their outputs and the price of the product will increase further, but probably still not by the full amount of the tax. The short-run reaction to the new tax in this example is therefore that both sellers and consumers likely absorb some of the burden of the tax. The consumers will be paying a price higher than the pre-tax price and firms will be receiving less revenue because of selling fewer units and because the post-tax price has fallen from the pre-tax level. The magnitude of the price increase is related both to the behaviour of the producer's costs as output declines and to the behaviour of the purchasers as the price increases. Generally speaking, tax-induced price increases will reduce purchases of the taxed commodity least if the commodity is a necessity or if close substitutes are also taxed. The prices of non-taxed commodities will tend to rise both because consumers may shift away from taxed commodities and purchase more of these non-taxed items and because some of the proceeds from the tax may be spent on non-taxed items.

25. A longer-term reaction may be that some firms will drop out of the industry whose profits have fallen because of the new tax, while new firms will enter other industries whose prices—and presumably profits—have risen because of the increased demand for non-taxed commodities. Thus, prices in the taxed industry will tend to rise as production falls and prices in the non-taxed industries will tend to fall as production rises. Once again, the magnitude of these longer-run price changes will depend upon conditions of cost and of demand for the products. The final price for the taxed commodity may have risen by an amount greater than, equal to or less than the amount of the tax.

26. If, in contrast to the assumption of the preceding paragraphs, one firm is able to exercise control over price and hence enforce a pricing "policy" for itself and its industry, it may decide to charge a greater part of the tax to its customers, but the price may still not rise by the full amount of the tax. In other industries, where firms exercise some control over price but are subject to competition from other firms, the impact of placing a tax on a commodity is difficult to analyse. In industries where there are only a few large firms it is likely that prices will immediately increase by the full amount of the tax. In industries where

[2]For a more comprehensive discussion of the incidence of the sales tax, see the special study prepared for the Committee by Kenyon E. Poole, *Sales Tax Economics*, Section 4.

there are a greater number of firms, while the impact of a tax on price will not be felt as quickly, nevertheless the price will eventually rise by an amount that approximates the tax.

27. Although the foregoing analysis is made on the assumption that the general price level remains relatively constant, the conclusions follow even under other circumstances. If prices are generally rising, firms may, instead of absorbing some of the tax by cutting pre-tax prices, simply raise prices by a smaller amount than they would have raised them in the absence of the tax. In addition, this analysis has neglected the impact of the sales tax on the levels of employment and economic activity, because we have assumed that the taxes were not large enough to affect these variables.

28. When a sales tax encompasses nearly all commodities rather than just one, the magnitude of the previously described price and resource movements is small. If a general sales tax without any exemptions is introduced, the retail prices of all commodities tend to move upward together, since the tax represents the same percentage increase applied to the price of each good. Although the response of consumers to a price rise is not the same for every commodity, the changes in this circumstance will not be as significant as they would be if the tax were imposed on only a few goods. The only part of a taxpayer's income that escapes a general sales tax is his savings, and a taxpayer is not likely to increase his savings to avoid sales tax. In addition, where all commodities are taxed, there is less impetus for firms to move out of one industry and into another. In such circumstances, the accepted opinion is that a general sales tax is borne by consumers in the form of higher prices. But there is, nevertheless, a view that the tax is shifted back to the suppliers of labour and other resources in the form of lower wages and other cost payments by firms. The proponents of this backward shifting assumption develop their case by analysing the effects of the tax alone, without considering how government spends the proceeds of the tax. They argue that some of the purchasing power of consumers will be siphoned off by the government, with the result that either prices must fall, if production is to continue to be sold, or prices will remain high, and then unemployment will result. In either case, it is argued that the burden will be borne in the final analysis through lower incomes rather than through consumption.

29. This analysis completely ignores the possibility that the government may increase its expenditures as a result of the revenue received from the new tax. It is recognized that the government may allocate the increase in its expenditures differently from the expenditures that the taxpayers would have made if no tax had been imposed, and thus affect the relative profitability of various industries. However, if some of the tax receipts flow to the government because taxpayers reduce their savings, the combined effect of the tax and government expenditures will be expansionary.

30. It is by no means inevitable that, when a government levies a general sales tax, thereby siphoning private funds to its own coffers, total revenues accruing to producers from the sale of the economy's current output need decline. The

government may promptly spend much of the tax revenue it receives and consumers may maintain spending by drawing on savings. Again, the federal government may pursue a policy that adds to the country's total supply of money, thereby encouraging greater spending. In short, monetary policy will influence greatly the general price and employment effects of a general sales tax and hence the direction of shifting that may occur. Contrary to the view that some part of a general sales tax is necessarily shifted back through declines in the general price level (including the price of labour and other forms of income), we think it more likely that the general price level will rise with an increase in sales taxes. Even if such a rise does not occur, the conclusion of this backward shifting does not necessarily follow. If, for example, the general price level remained stable, through increases in the prices of taxed items and decreases in others, the burden of the tax would then be distributed according to the purchase of taxed items rather than through declines in the price of labour and other forms of income.

31. In a dynamic situation where changes in consumer preferences, technological advances, and increases in income and prices are continuous, it is difficult to determine by actual market study the incidence of the Ontario retail sales tax. However, on the basis of our theoretical analysis, we support the argument that the retail sales tax is borne by consumers. Therefore, although we recognize that the final retail price of every taxed commodity does not change by the full amount of any tax change, we believe that this is the best single assumption that can be made.

DISTRIBUTION OF BURDEN AMONG TAXPAYERS

32. Having taken this position regarding the incidence of the sales tax, we can now examine the distribution of its burden among families, according to various income classes. This investigation is based on our research which is summarized in Chapter 5. Here a more detailed analysis is useful, in order to determine whether the tax bears more heavily on low-income classes and is as regressive as is often maintained. It is also useful in measuring the impact of the major exemptions on the distribution of the sales tax burden. Although non-residents of the province, largely tourists, bear some of the tax through their purchases, we estimate that about 91 per cent of the tax is borne by Ontario residents.

33. Table 29:1 is based on the highly simplified assumptions that consumers bear the tax in proportion to their purchases of taxable items and that consumers who are resident in Ontario bear 91 per cent of the total tax. The Table shows in A that the existing Ontario retail sales tax burden, in terms of family income distribution, is proportional over the first two family-income brackets, progressive between the second and third brackets, roughly proportional from the third bracket to the sixth bracket, and regressive to the final bracket for incomes of $10,000 and over. Our researches indicate that if the burden is computed by using expenditure rather than income as the base, the tax becomes more progressive.

34. We have heard suggestions that the removal of the exemption for food would simplify the administration of the tax and allow the current amount of

revenue to be raised with a lower tax rate. If all food were subject to the levy, current revenues at the 5 per cent rate could be obtained with a tax rate of only 2.7 per cent. Taxing food would, as the Table shows in B, make the present sales tax regressive, the impact being particularly significant in the lowest income bracket where food is a large proportion of total family expenditure. It has been suggested that the regressiveness caused by the taxation of food could be offset if appropriate cash rebates were paid to families on a per-capita basis. In Ontario, we estimate that an annual rebate of $30 per person would return the total tax of over $200 million that would be paid on food if it were taxed at the 5 per cent rate. The figures in C of Table 29:1 indicate that such a rebate would make the tax much less regressive than in B, but the combined effect of taxing food and paying rebates changes the burden pattern only slightly from the existing tax which exempts food. This change from the current situation would come about because the rebate in the $2,000 to $3,999 income classes is greater than the amount of the sales tax that these families would pay on food. For the two highest income classes (those over $6,999), the reverse situation is true because the tax on food expenditures would exceed the rebates.

TABLE 29:1

BURDEN OF ONTARIO RETAIL SALES TAX EXPRESSED AS A PERCENTAGE OF FAMILY INCOME

	Under $2,000	*$2,000 to $2,999*	*$3,000 to $3,999*	*$4,000 to $4,999*	*$5,000 to $6,999*	*$7,000 to $9,999*	*$10,000 and Over*
A. Burden of present tax at 5% rate	1.55%	1.47%	2.03%	1.87%	1.96%	2.08%	1.54%
B. Burden if food is taxed and rate reduced from 5% to 2.7%	2.52	1.66	2.07	1.92	1.94	1.93	1.35
C. Burden if food is taxed, rate left at 5%, and annual per-capita rebate of $30 given....	1.58	1.14	1.54	1.55	2.02	2.38	1.83
D. Burden if all goods and services taxed without exemptions and rate is reduced from 5% to 1.6%	2.41	1.66	2.01	1.96	2.01	1.89	1.72

Note: These calculations are based on 1961 statistics. They present the pattern of tax burden that would have resulted if the various sales tax plans had been in existence in 1961. In all four cases the yield from the tax would be the same.

35. A fourth possibility, presented in D of Table 29: 1, is to remove all exemptions and to tax services. In this case, the yield of the present tax could be obtained at a rate of 1.6 per cent. If this alternative were implemented, the Table indicates, the tax would be more regressive than in A and C and similar to B, except for the $10,000 and over class. When compared to A, the tax burden is higher on the $2,999 and under classes because expenditures on food and other exempt items

form over 70 per cent of total expenditures incurred by this group. The burden is also higher on the $10,000 and over class because the effect of the lower rate is outweighed by the inclusion of services.

36. In summary, these examples indicate that the existing tax is more equitable than two of the alternatives and that it is slightly less equitable than the pattern obtained by taxing food and giving rebates to individuals. However, it is questionable whether the rebate plan would as effectively meet the social objective of removing the burden of tax on food as would the exemption method. This is because individuals may view the rebate as a windfall and use it for purposes other than the purchase of food. Moreover, because of whatever time lag might occur between the payment of the tax on food items and the subsequent rebate of the tax there is a cost which, while uniform for families of the same size, bears more heavily on those of low incomes. Finally, the administrative saving to be achieved by removing the exemption from food would in all likelihood be more than offset by the cost of administering the rebate system.

37. Although the above analysis sheds some light on the effects of various rates and bases of sales tax coverage on different family-income classes within the province, the importance of these findings should not be overemphasized. As discussed in Chapter 5, the impact of government policy on income distribution should be examined in the context of all revenue and expenditure programs, rather than on an individual tax or expenditure basis. The impact of any one tax may be counterbalanced or outweighed by other taxes and expenditures. As is evidenced by the Table, none of the suggested variations of the sales tax significantly affects the impact of the total tax burden. In addition, the values given in the Table are based on averages that do not take into account important variables such as family size, age of family head, wealth, permanency of families within an income bracket, or various other factors that affect the ability to pay tax. These burden patterns are helpful, however, in making a decision between alternative revenue sources or variations in the structure of the same tax.

ECONOMIC EFFECTS OF SALES TAXES[3]

38. In addition to its direct effects upon the distribution of income among Ontario families, the levying of the retail sales tax contributes a number of other economic influences. While the contribution to revenue is substantial, the other economic effects are not likely to be great at a 5 per cent rate of tax. Nevertheless it is useful to be aware of their general nature, particularly in comparing and evaluating the desirability of increasing the use of the retail sales tax, in preference to another tax or revenue source, since the effects of the tax become more and more pronounced as the rate rises.

Revenue Yield

39. One obvious effect of the utilization of a retail sales tax is to increase the revenue yield of the provincial tax system where economic, political and consti-

[3]Much of the material in this section is based on Poole, *Sales Tax Economics*, Section 7.

tutional limitations have restricted the amounts of revenue that can be raised from other sources. Furthermore, there are financial and economic limits within which the Province's program of deficit financing must be contained in any given period. In making possible a larger flow of funds to the provincial government, the extension of the sales tax increases the amount of government expenditure that can be undertaken. Although the extending of the retail sales tax increases the potential size of the public sector of the economy, two questions remain to be answered. The first is whether it is a desirable objective to increase the scope of government, and second, if it is, whether the retail sales tax is the best vehicle to use in accomplishing this objective. To answer the first question, assumptions must be made in regard to the expenditure program financed by the retail sales tax revenue, the private programs that would have otherwise been undertaken and the relative desirability of each. Any analysis of this nature would be arbitrary and certainly beyond the scope of our inquiry. We can make some pertinent comments, however, about the effects of using the retail sales tax, rather than alternative revenue sources to finance existing expenditures.

Frictional Effects

40. All tax programs involve so-called "frictional" effects. These include changes in work effort, consumption and production patterns as well as administrative effects on firms and individuals. In general, it is viewed as a virtue if a tax has slight frictional effects. Although it is impossible to prove the superiority of one tax over another in this regard, some generalizations can be made about the retail sales tax. Where a tax is borne by individuals in proportion to their expenditures rather than to their incomes, their incomes from work effort are obviously not directly subject to the tax. There may well be an indirect encouraging effect on work effort, because the retail sales tax increases the cost of goods and products purchased, but this effect is likely to be small. In this respect, the retail sales tax is generally regarded as superior to the personal income tax because the latter directly lessens the income from work effort and does so at *progressive* rates. Income received from the extra or marginal work effort is taxed more heavily than average income.

41. A general retail sales tax will tend to be neutral with respect to the distribution of expenditures on the various kinds of goods and services. Where exemptions are granted to particular commodities, the effect is to increase expenditures on them. To the extent that it is socially desirable to increase these expenditures, exemptions will improve existing purchasing patterns. However, if there are no social benefits associated with greater expenditures on certain goods, the exemptions will distort the pattern of consumer purchases. The taxing of some producer goods and not others likewise distorts production processes away from the most efficient use of resources.

42. The retail sales tax is superior to the turnover tax, the value-added tax, or the federal manufacturers' sales tax, because it minimizes pyramiding and double taxation and its incidence is less uncertain.

43. While the government's administrative costs are low in relation to the yield of the retail sales tax, the use of such a tax does involve additional cost to retailers in determining and collecting the tax and keeping the books, records and documents prescribed in the Regulations. The cost of administering a sales tax at the retail level is obviously higher than for one at the manufacturing or wholesale level because of the greater number of business establishments involved in the process of tax collection. It is difficult to compare retail sales taxes and personal income taxes on this score, because each embraces many variations. But administrative costs to business firms and individuals, both as taxpayers and collectors or withholders of the tax, are likely to be similar for both taxes.

Effects on Saving and Consumption

44. It is generally argued that a sales tax will discourage consumption and encourage savings. This is because the tax is levied only on consumption and individuals will tend to substitute savings for consumption. This argument is valid if a comparison is made between an income tax and a sales tax or if the introduction of a sales tax is coupled with an expenditure program that allows individuals to maintain the pre-tax standard of living. However, if a comparison is made between pre-tax and post-tax situations, and if changes in government spending are not considered, the impact of a sales tax on consumption and saving is not clear. Many factors are relevant in analysing the effects of the tax, but we limit our discussion here to two of major importance. First, the tendency to increase saving and reduce consumption is much stronger if it is believed that the tax is temporary rather than permanent. If the tax is permanent, there is little to be gained by postponing expenditures. Second, the effect of the tax is different on different income groups. If the tax is expected to be permanent, the following effects are generally encountered. For low-income individuals who spend nearly all of their income and who do not save systematically, the sales tax likely increases the amount spent on consumption and reduces the amount saved. Many middle-income individuals have fixed savings commitments in the form of insurance and other savings plans. These individuals may increase, decrease or keep their levels of saving constant. Individuals with high incomes normally maintain their standard of consumption and their savings fall when a sales tax is imposed. However, the impact of the Ontario tax on consumption and saving is not as large as that of a general sales tax would be, because many items are exempt and consequently the prices of these items may not rise. Thus, the impact of a retail sales tax, and particularly the Ontario sales tax, on consumption and saving is likely to be small.

Effect on Economic Growth

45. It is often argued that with reference to the objective of sustained economic growth, the sales tax is to be preferred to a personal income tax. This assertion rests on the fact that the personal income tax is progressive and that most of the personal flow of investment funds is provided out of savings by individuals with high incomes. The desire and ability to provide funds for investment is believed to be much more greatly reduced by a personal income tax than by a sales tax.

It is also argued that there will be a shift away from consumer goods and toward production goods because only consumer goods are taxable. Although this line of argument is valid if after the tax is imposed there is still adequate market demand for current production, it may not be completely correct when the return on new investment is inadequate as it may be during periods of low economic activity. The unemployment experienced during periods of low economic activity may make it at least as important to stimulate consumption as to provide funds for investment. Therefore, the argument for a sales tax on the ground that it will be more consistent with economic growth than an income tax is valid only if a shortage of investment funds is the chief problem. But the effect on economic growth of the two taxes is likely to be similar if the chief problem is inadequate demand for current production.

Effect on Inflation and Deflation

46. On the one hand, it is argued that sales taxes are deflationary because they tend to reduce consumption. On the other hand, sales taxes are sometimes thought of as being inflationary because of the price increases that they occasion. Not only do goods increase in price as a result of the tax, but many labour contracts in Canada are tied to the Consumer Price Index, and thus wages increase as a consequence of an increase in the tax. The combination of the inflationary and deflationary effects of the tax depends upon the economic conditions prevailing at the time the rate of tax is increased, but a rise in consumer prices is highly probable.

Relationship to the Business Cycle

47. The yield of the sales tax moves in the same direction as the business cycle because aggregate taxable purchases rise and fall with economic activity. However, the yield of the sales tax is not nearly as responsive to changes in economic activity as that of the personal income tax. The yield from personal income tax changes more than proportionately to changes in income. This is partly because the personal income tax is progressive, with the effect that individuals with increasing incomes generated by the expansionary phase of the business cycle move automatically into higher tax brackets. When business activity falls, incomes decrease so that individuals are again automatically placed in lower income tax brackets. The income tax is also more responsive than the sales tax because national income fluctuations are greater than the fluctuations in expenditures. This responsiveness of tax yields to the changes in economic activity is a virtue in that it acts as an automatic stabilizer of the economy. In this connection, we have argued earlier that although the responsibility for economic stabilization has hitherto rested mainly with the federal government, the increasing use by the provinces of their fiscal powers makes it imperative that effective provincial action be undertaken in this area, if the nation's broad economic objectives are to be achieved. It is nevertheless true that from the standpoint of a stable yield, the sales tax is superior to the personal income tax and that it therefore represents a highly desirable component of the provincial tax system.

48. Over time, the yield of the sales tax is likely to increase with increases in income. Although individuals in the higher income brackets spend a smaller proportion of their income than those with low incomes, the proportion of national income spent remains relatively constant. While the yield of the sales tax will not increase as much over time as that of the personal income tax, it will likely increase in proportion to income, particularly if expenditures on services are subject to tax. If services are not taxed, the expansion of revenue from the sales tax may fall behind the rate of growth of the economy because outlays for services represent a continuously rising proportion of total consumer expenditures.

THE TAX BASE AND EXEMPTIONS

49. The most important criterion of any tax, as we have said elsewhere in this Report, is equity. An equitable tax is often defined as a levy that taxes individuals in similar circumstances equally, and differentiates adequately between individuals in different circumstances. Considering similarity of circumstances in terms of equal expenditure, the Ontario retail sales tax places unequal burdens on individuals. Those persons who direct their expenditures toward food, services and other exempt items bear a lighter burden than those who direct the same amount of money to the purchase of taxable items. If similarity of income is chosen as the criterion, the differences in tax burden among comparable families are likely to be even larger. Individuals who have large families or are in the process of forming households bear a greater tax burden than other individuals with equal incomes. In addition, those individuals who prefer taxable to non-taxable commodities, or reside in urban rather than rural areas, or have spendable wealth, or are young and have stable incomes, are likely to bear a heavier burden than other individuals with the same income. Notwithstanding these rather obvious inconsistencies among individuals in different circumstances, the Ontario retail sales tax burden tends, according to our studies,[4] to increase nearly proportionately with increases in expenditure. Its burden increases at only a slightly lower rate than the rate of increase in income.

50. The equity of any tax is initially affected by the pattern of exemptions embodied in its structure. As mentioned previously, the Ontario retail sales tax is not all-inclusive in that a number of categories of expenditures are exempt from the tax. There is no completely general retail tax to be found anywhere, but the types of expenditures that are exempt differ markedly between governments that use this source of revenue. The exemptions under the Ontario legislation are similar to those allowed in other provinces of Canada but are more numerous than those found in many of the states in the United States. The Ontario government has nevertheless adopted the position that retail sales of tangible personal property should be generally taxed and that expenditures in respect of real property, services and intangible personal property should not be taxed. The exemptions allowed in the Ontario retail sales tax appear to be justified on a variety of grounds, and some exemptions can be justified on more than one. We group those items

[4]For a more thorough discussion of the economic effects of exemptions, see Poole, *Sales Tax Economics*, Section 6.

of tangible personal property which are presently exempted in four main categories, according to the nature of the basic reasons for each.

REDUCTION OF REGRESSIVENESS

51. Our first category of items includes expenditures that are exempted from the tax in an effort to make the levy a better measure of ability to pay. As indicated in Table 29:1, a tax that included all retail sales would bear very heavily on lower-income families, and would therefore be steeply regressive. This is because the proportion of income actually spent by families decreases as income increases. Consequently, if the tax were all-inclusive, a low-income family would pay a larger proportion of its income in the form of sales tax than would a high-income family. Families that incur unusually heavy medical expenditures would also bear a heavy burden. Thus, to alleviate the regressiveness of the levy, expenditures that are considered necessities and form a large proportion of expenditures incurred by low-income families are exempt from the tax. Here the best illustration is the exclusion of food from the tax base. Other exemptions at present placed in this category include rent, fuel and electricity, prescribed drugs and medicines, and children's clothing.

52. All exemptions reduce the size of the tax base, and thereby reduce the proceeds obtained from any given rate of tax. For example, we have calculated that a 1.6 per cent sales tax without exemptions would yield the same revenue as the present 5 per cent sales tax with exemptions. In addition, any exemption greatly increases the complexity of administering the tax and at the same time violates the principle of tax neutrality. For instance, the exempting of food and medical supplies adds to the complexity of administration because decisions must be made on marginal items such as candy, soft drinks, weight reducers and patent medicines. In the case of children's clothing, the size at which clothing becomes taxable must be arbitrarily determined. The basic problem in determining the most appropriate range of exemptions in this category is whether the gain obtained in more closely meeting the test of ability to pay compensates for resulting inequities, increased administrative cost and other disadvantages, such as the effect on revenue, which inevitably result from granting the exemptions.

53. We have concluded that if the tax is to avoid imposing a heavy burden on low-income families and families with many children, the food exemption must continue, notwithstanding the fact that this present exemption reduces tax revenues by more than 40 per cent. But the present definition of food is complex and contains many anomalies. For instance, buttered popcorn is exempt but candied popcorn is not. Cider is exempt but root beer is not, and the rule is apparently derived from arbitrary distinction between luxury foods and staples. Is a plain processed cheese a staple that is transferred into a luxury on the addition of pineapple? Is it a proper distinction to regard domestic foods as staples and imported foods as luxuries? If a loaf of plain white bread is basic, where is the line drawn as one considers raisin and egg loaves, melba toast and shortbreads? These examples could be multiplied endlessly. The inevitable conclusion is that if administration is to be simplified and if arbitrary judgments are to be avoided, all food products

for human consumption must be exempted. As explained below, we see no serious inequity in the continuing taxation of prepared meals and of alcoholic beverages. Our view therefore supports the exemption of all edible foods including such marginal items as candy, confections, soft drinks, vitamins, food supplements, dietary supplements, saccharin, insulin and the like. Other non-food products such as patent medicines, cough preparations and so on would continue to be taxed excepting, however, prescription drugs and medicines. *We therefore recommend that:*

> ***All food products for human consumption, excluding prepared meals and alcoholic beverages be exempt from retail sales tax.*** 29:1

54. While we would exempt, *in toto*, food prepared for home consumption there remains the problem of how to treat prepared meals. Saskatchewan was the only Canadian province imposing a sales tax that allows a total exemption for such meals until 1966, when British Columbia passed legislation repealing the sales tax on all prepared meals. Quebec does not tax meals under its Sales Tax Act but rather imposes a meals and hotels tax of 8 per cent on all meals costing more than $1.25. All the remaining provinces tax meals. Newfoundland imposes a tax on all meals costing over 17¢. New Brunswick, Nova Scotia, and Prince Edward Island tax all meals above $1.00. The Ontario tax provisions are most "generous", in that they exempt meals costing up to $1.50.

55. The intent of this exemption is to tax "luxury" eating in restaurants, but not to create a hardship for persons who are forced to eat meals at their own expense in restaurants, rather than carry a tax-free lunch pail. Many people do not return to their homes or bring a lunch to the places of their employment. It is therefore reasonable that a liberal exemption be established so that such persons are not subject to tax. It is our opinion that the present exemption for meals of $1.50 or less is realistic at present price levels.

56. We do feel, however, that the present base should be broadened to include all prepared meals, whether eaten on or off the premises where prepared. We can see no logical reason why food delivered to one's home should not be taxed on the same basis as meals served in a restaurant.

57. A difficult administrative problem with the drive-in restaurants would be solved by this proposed broadening of the tax base. At present, prepared food (hot dogs, hamburgs, sandwiches, french fried potatoes) sold by these establishments is taxable if eaten on the premises, when the total charge is in excess of $1.50. Very little tax is collected by these businesses, because the place of consumption is usually unknown at the time of sale. By broadening the base as suggested, this problem is solved; the only criterion of taxability is the price.

58. The size-of-the-check rule for the determination of taxability of a meal appears to us to be the most efficient and effective from an administrative point of view. The ill will created when two persons, each of whom has a meal of $1.50

or less, are given one check amounting to more than $1.50 can be avoided by requiring restaurants, in the absence of contrary instructions from a patron, to issue a separate check for each meal served. Thus, the intent of the Act to avoid taxing individual meals of $1.50 or less will be fulfilled.

59. Meals and beverages served in places of entertainment that are subject to tax under The Hospitals Tax Act are exempt from the retail sales tax. In Chapter 31 we recommend that The Hospitals Tax Act be repealed and that expenditures now taxed under that Act be subject to retail sales tax.

60. For the reasons expressed above, *we recommend that*:

Each commercially prepared meal sold for more than $1.50 be taxed regardless of the place where it is consumed. **29:2**

61. All medicines, drugs, and orthopaedic, dental and optical appliances prescribed by doctors and dentists should continue to be exempt, to avoid adding to the difficulties of persons who bear the burden of such extraordinary expenditures.

62. The distinction between taxable and exempt children's clothing and footwear is at present determined entirely by size rather than by the age of the intended user of the clothing. Administratively, this has been found the most practical way of granting the exemption. The result is that small adults can benefit from the exemption and large children are denied it. Articles that are not produced in so-called "children's" sizes are all taxable. In short, we believe that this exemption is open to much abuse and often fails to provide relief where most needed. The Regulations were changed in 1967 so that the exemption would apply to sizes of clothing designed for larger children. This, while desirable, increases the opportunity for avoidance by small adults. Nevertheless, we have concluded that the exemption does contribute to the over-all equity of the tax and, as we have been unable to discover any better method of granting the needed relief, we conclude that it should be continued in its present form.

63. Various heating fuels and electricity are now exempt. While food clearly is the most significant single annual expenditure made by families, heating fuels and electricity also are important items in the family budget, as well as being part of industry's cost of producing taxable goods and services. We therefore believe that this exemption too should be continued.

64. In summary, we hold that a broad definition of food for exemption purposes, the continued exemption of prescribed medicine and health aids, of children's clothing and of heating fuels and electricity all contribute significantly to a lessening of the regressiveness of an otherwise general retail sales tax.

AVOIDANCE OF PYRAMIDING AND DOUBLE APPLICATION

65. A second category of exemptions is that relating to sales of intermediate or producers' goods. These are goods that are sold not to ultimate consumers but usually to manufacturers, wholesalers or other purchasers at various stages of the productive process. Although these exemptions are dictated in part by the consti-

tutional prohibition against indirect taxation, there are also sound economic reasons for exempting the sale of producers' goods. Wherever intermediate goods are taxed, the tax is pyramided through the subsequent stages of production right down to the final purchaser. This represents a violation of tax neutrality, because where a general sales tax is applied at any intermediate stage of production the resulting changes in retail prices will be far from uniform. These changes will depend both on the number of times the product changes hands and on the pricing policies practised by various industries. As we have already suggested, the possibility of pyramiding causes distortions that work to the detriment of both producers and consumers of goods whose production is not fully integrated and which pass through several exchanges in the course of production. This problem is recognized in the federal sales tax levied on manufacturers. The government has been forced to make thousands of rulings directed toward arbitrarily restoring a taxpayer's basic selling price to a notional manufacturer's price, in an effort to maintain fairness among taxpayers.

66. It is not administratively practical, however, to make the exemption of intermediate or producers' goods complete. Ontario exempts all goods that become physical ingredients or component parts of finished retail goods. In addition, all machinery directly used in production is exempt. But items sold to producers that do not become embodied in the final product, such as office equipment, motor vehicles, building materials, and some non-production machinery, are taxable. It has been suggested that perhaps one-fifth of the sales tax revenue comes from the sale of such non-exempt goods to producers.[5] In principle, all goods purchased by business firms should be treated uniformly. The provision of office equipment, motor vehicles and building materials affects the cost, and consequently the retail price, of products sold by manufacturers, just as much as do the direct costs of raw materials and production machinery. The major difficulty in providing complete exemption for producers' goods is administrative complexity. In particular, many currently taxed producer goods are sold at retail to consumers, as well as to producers. There would therefore be great difficulty in distinguishing between purchases made by a manufacturer for production and those made for personal use. Effective enforcement would involve high administrative costs. The result, however, is that in addition to the pyramiding effect of the tax on the non-exempt portion of the cost of production, there is a doubling of tax upon the sale of the product to the extent that tax is again collected on the portion of the price equal to such previously taxed cost.

67. In addition to Ontario, the provinces of New Brunswick, Nova Scotia and Prince Edward Island exempt production machinery generally. Quebec provides a partial exemption, and Newfoundland, Saskatchewan and British Columbia provide no exemptions. The Ontario provisions exempt "machinery and apparatus and parts thereof as defined by the Treasurer, that in his opinion are to be used by the purchaser thereof directly in the process of manufacture or production of tangible personal property for sale or use". Retail sales tax Regulation 22(2) defines

[5]See John F. Due, *Provincial Sales Taxes*, Canadian Tax Foundation, 1964, p. 52.

"machinery and apparatus and parts thereof" as those "that come in direct contact in the manufacture or production of tangible personal property for sale" but not including certain general classifications listed in the Regulation. Numerous rulings and arbitrary decisions are required to be made as to taxability as there are many purchases that do not easily fit into the listed categories, the tendency being in these fringe areas to tax rather than to exempt. We think that the definition should be expanded so that at least the following classifications of machinery and apparatus and parts thereof are exempt:

1. Laboratory testing equipment,
2. Machine shop equipment,
3. Machinery repair and maintenance equipment,
4. Handling equipment for use during production process, and
5. Small tools supplied employees, without charge for use in production.

Accordingly, *we recommend that:*

The present exemptions from sales tax be reviewed and revised so that: **29:3**

(a) all purchases of machinery, equipment and other goods that enter into the direct costs of manufacturing and producing will be exempt; and

(b) purchases of all goods entering into indirect costs of manufacturing and producing will be taxable.

68. The Act exempts many items used by farmers, fishermen and hunters, and here the very close parallel to the position of manufacturers is readily seen. However, like industrial producers, farmers purchase many items from retailers who also sell to customers who are not farmers. By and large, the present Ontario sales tax manages to chart a navigable course in the matter of exemptions in this very difficult area and it is unlikely that any changes would noticeably improve equity.

69. Advertising costs incurred by business firms represent a form of producers' expenditure worthy of special attention. In this connection, we note that the Royal Commission on Taxation of Quebec has recommended that advertising be subject to the sales tax. The question of whether advertising should be taxed is not easily answered.

70. On the one hand, advertising is an expense involved in selling and such costs are built into the price of the product in the same manner as the costs of raw materials. Therefore, the taxing of both the advertising and the final product would result in a form of double taxation that would cause price distortions that would work to the disadvantage of both the consumers and the producers of heavily advertised products. It can therefore be argued that because advertising is a producer's cost, it should be treated in the same manner as physical goods used directly in production.

71. On the other hand, indirect costs of production are generally taxable in Ontario, primarily because of administrative considerations. It is widely recognized that the taxing of services would improve the equity of the sales tax, and because advertising is a service, and is not directly used in production, it can be argued that advertising expenditures should be subject to the sales tax. We have recommended that goods purchased by producers should not be taxed, wherever their exemption is administratively feasible. We therefore do not favour subjecting more business expenditures to the sales tax except for compelling administrative reasons. Advertising expenditures are incurred primarily by business firms rather than by consumers, so that the administrative justification for taxing goods generally sold to both producers and consumers, such as furniture and furnishings, does not apply. Furthermore, while the tax on advertising outlays would initially be borne by business firms, undesirable double taxation would surely follow, and pyramiding effects probably would also. We have therefore rejected the proposition that advertising should be taxed, on the grounds that such a policy would be contrary to our economic objectives.

72. We note in passing that "machinery and apparatus and parts thereof as defined by the Treasurer", purchased by advertisers or their agents that in the opinion of the Treasurer are used to produce advertisements exclusively in newspapers or magazines are exempted. This very special and narrow exemption should be reviewed and revised in accordance with our recommendation in paragraph 67 above.

ADMINISTRATIVE SIMPLICITY

73. A third category of exemptions encompasses transactions that are excluded solely for administrative reasons. In the Ontario sales tax, the principal example of this type of exemption is where the sale of any goods has amounted to less than 21¢. Originally this exemption was set at 17¢ because, at the former rate of 3 per cent, the tax was less than ½¢ on any sale below this amount. However, numerous sales of items such as candies and soft drinks, which might ordinarily aggregate 20¢, were often "rung up" as two sales of 10¢ each, to avoid the tax. At the present rate of 5 per cent, a tax of ½¢ would apply to a sale of 10¢, in the absence of any exemption. To bring the exemption into accord with the new rate of tax, we believe that it should be changed to cover all sales of less than 11¢. In future the exemption should be set at a figure near the point where ½¢ of tax would otherwise apply, keeping it just above any frequently used price level such as 5¢ or 10¢. For the current rate of tax, *we recommend that:*

> ***The present provision exempting all sales of less than 21¢ be amended to exempt sales of less than 11¢.*** **29:4**

74. Draft beer sold by the glass in licensed premises has been exempt mainly because of the difficulty of enforcing the tax where the price of one glass was less than 21¢, and it would therefore apply only where several glasses were sold in one transaction. There would be no such difficulty if generally all sales in excess of 10¢ were taxed as we have recommended. The present exemption for beer sold by

the keg to licensed premises for sale by the glass in such premises would no longer be required as the licensed premises would then be able to provide a purchase exemption certificate for the purchase of beer for resale. *We therefore recommend that:*

> ***The present exemption from sales tax for draft beer sold by the glass on licensed premises be repealed.*** **29:5**

FOR THE SOCIAL GOOD

75. The fourth category of exemptions relates to transactions that are encouraged because of their social desirability. These exemptions relate to a very broad range of activities. Exemptions for books and classroom supplies are designed to avoid adding costs to general education. Exemptions given to hospitals and charitable institutions reflect a desire to encourage these institutions in their work of providing essential services to the public. Exemptions granted to religious organizations likewise fit into this category. However desirable these activities may be, every exemption narrows the tax base and increases administrative costs, while the gain that each achieves in stimulating socially desirable activities may be exceedingly difficult to gauge. For most of the items included in this category, we believe that the social objectives could be more effectively stimulated through direct government grants. Moreover, we believe that the benefits flowing from the present exemptions do not compensate for the administrative difficulties that they create. It is for these reasons that we believe that each exemption included in this category should be carefully reviewed.

76. The Act exempts certain items purchased by schools, hospitals and religious institutions, but the administration of these exemptions is particularly troublesome. As just one example of the problem, we note that a hospital-equipment dealer is faced with two questions on every sale to a hospital. First he must determine whether the equipment he is selling is to be used directly in the treatment of patients, and, if so, he must then determine whether his customer is a "public" hospital under the statute. His records must be sufficient to show to the sales tax auditor the answer to both of these questions. A further example is the case of the lowly paper clip. If purchased by a school for use in a commercial course classroom it is exempt, but if used in the general office of the school it is not. If this same paper clip is purchased for use in a commercial course classroom, by a commercially operated business college rather than a school operated by a municipality, it again loses its exemption. The sales tax auditor must inspect all the records of the paper clip seller to make sure that tax was collected from each purchaser who was not exempt. These two examples underscore the problem that arises from an exemption based upon the end use of the product. The problems created by these conditional exemptions illustrate the fact that exemptions are a very inefficient and imprecise way of stimulating socially desirable ends.

77. Many but not all goods purchased by municipalities are exempt from sales tax in Ontario. For instance, buses for municipal transit are exempt, as are street-cleaning and fire-fighting vehicles purchased by a municipality, university or public hospital at a price of more than $1,000 per vehicle. Materials or goods going

directly into and becoming part of the construction of municipal capital works are likewise exempt. This exemption occasions much record-keeping by all parties as well as verification of the claims by special departmental audits. We do not think that the advantages gained here really warrant a departure from our general principle of minimizing exemptions, especially in view of our recommendations relating to municipal grants, that we detail elsewhere in this Report.

78. Art galleries and museums that receive support from public donations and public grants in excess of half of their total revenues may purchase works of art, as defined by the Treasurer, free of sales tax. While few persons would deny that museums and art galleries serve the public good, this exemption fails to pass the tests of simplicity and certainty. There are many institutions and organizations that purchase such works, apart from the art galleries and museums that qualify for the exemption. Finally, to the extent that these institutions need assistance from the government—and clearly all but the religious institutions do receive such support —grants are the proper way to provide public assistance, rather than subsidies which under the present exemptions are buried in the tax system. It should be recognized that devising and administering such a system of grants will not necessarily be simple, but this does not make the suggested change any less desirable. *We therefore recommend that:*

> ***All exemptions of tangible personal property purchased by or for schools, school boards, universities, hospitals, nurses' residences, religious institutions, Ontario municipalities and publicly supported galleries and museums, and the exemption for buses purchased for public transportation within a municipality be repealed.*** **29:6**

79. Most people readily agree that the reading of educational books and magazines is socially desirable. It is the practical application of this principle that presents serious difficulties. A proposal to exempt James Bond adventures or the current issue of *Playboy* may not strike quite the same responsive chord as one relating to Boswell's *Life of Johnson*. An example of the fine distinctions drawn is that a sales catalogue is exempt provided the prices of goods are printed in it, but catalogues in general are taxable. Many vendors have no doubt sold trade directories and periodic reports free of tax when they should have been taxed. We have considered the possibility of restricting the exemption to worthy works which might be described as technical, educational or literary. However, the administration of such a list of books and magazines defies tranquil contemplation, for the drawing of clear distinctions is impossible. Defining a good book presents the same kind of difficulty as defining a luxury food. However, regardless of the merits of an exemption for "good" books, we doubt that their readers are likely to change their reading habits because of a 5 per cent sales tax. As a consequence, we have concluded that all books, magazines, and publications, whether purchased singly or on subscription, should be taxed. *We therefore recommend that:*

> ***The exemption of books, magazines, periodicals and religious and educational publications be repealed.*** **29:7**

80. Students' supplies as defined by the Treasurer are among the group of exemptions in aid of education. While the exemption covers graph paper and lined foolscap in book form, punched loose-leaf refills and the like, the same stationers sell stenographers' notebooks, ring binder refills and similar items that are taxable. It is readily apparent that there exists here a wide potential source of evasion or, at the least, considerable room for honest error on the part of vendors. The administrative confusion arising from this exemption does not seem to be offset by any reasonable gain for education. *We therefore recommend that:*

The exemption of students' supplies be repealed. **29:8**

81. Among the remaining exemptions are those related to particular government transactions. For instance, trees sold by the Department of Lands and Forests are mainly used as part of that Department's conservation program and thus are exempted. Here there is only one vendor, a department of government, and we see no reason to suggest removal of an exemption that clearly aids government objectives. Canada postage stamps and coins should likewise remain exempt when sold at their face values. If these items are sold in excess of their face value, then they have become the subject of trade and should be taxed as at present. Finally, goods such as gasoline and tobacco products subject to specific excise taxes under other legislation are at present exempted. In our chapter on Motor Vehicles taxation we develop our recommendations relating to the extension of the sales tax to include gasoline and other motive fuels.

SERVICES

82. To this point we have been considering the exemptions under the present Ontario retail sales tax, which is a tax restricted to the consumption of tangible personal property. While the Act does not impose any tax on services as such, it does tax some services under the guise of tangible personal property. Telegraph and telephone services and long distance calls are taxed as these are included in the statutory definition of tangible personal property. Rentals of tangible personal property are taxed by definition as a "sale". Otherwise, no attempt has been made to sweep services into the ambit of the tax. Because service industries have in recent years accounted for an increasing percentage of Canada's gross national product, a consideration of the many arguments relating to the inclusion of services within the base of the sales tax is relevant to our task.

83. A sales tax is imposed on the assumption that a taxpayer's ability to pay can in part be measured by his expenditures on consumption. Consumer expenditures are made for both goods and services, and it seems somewhat artificial to levy tax on the basis of the consumption of goods, while ignoring the consumption of services. Moreover, it has been found that as income rises, expenditures on services tend to expand more rapidly than expenditures on goods, with the result that services represent an increasing share of total consumption. Often it is difficult to distinguish between a charge made for goods and a charge made for services. For example, a manufacturer may sell his product at a rate that includes installation of the product on the customer's premises. The definition of "fair value" in The

Ontario Retail Sales Tax Act includes the cost of installation where the contract under which the item is acquired provides one consideration for both its purchase and its installation. However, where the vendor makes a separate charge for installation, there is no tax. Very often, it is difficult to determine the portion of the price that should be allocated to the installation, especially where the manufacturer sells all his goods on an installed basis. The same general situation holds true for goods sold under warranty, where the vendor contracts to keep them in good repair over a period of time without making an additional charge.

84. As the stage at which a sales tax is levied comes closer to the point of ultimate consumption, the arguments in favour of a tax on services become stronger. Since the distribution of goods to consumers is essentially a service function, and the charges for distribution services are included in the final price of the article on which tax is paid, the costs of distribution are in effect subject to sales tax. If other services are not taxed, the sales tax discriminates not only as between goods and services but between one service industry and another.

85. Because many retail merchants deal in both goods and services (e.g. garages, appliance dealers, repair shops, etc.), it is frequently difficult to distinguish between the charge made for goods and the charge made for services. Thus a retail sales tax that is imposed only on tangible personal property obviously discriminates in favour of expenditures on services. In view of the strong argument in equity that favours the taxation of services, and of the revenues that could be obtained from such a tax, it is somewhat surprising that none of the Canadian provinces has yet attempted to levy a tax in this area. We note with interest that the Government of Manitoba proposes to do so, as of mid-1967.

86. One of the reasons for the reluctance of the provinces to tax services has undoubtedly been the administrative difficulties involved in such a tax. We believe that these difficulties have been overstated in the past and that, in spite of the large number of service enterprises that would need to be licensed and dealt with by the Branch, a sales tax on services is both feasible and desirable.

87. There are two broad approaches by which a tax on services might be imposed. The tax might be applied generally to all services, with specified exemptions, in the same way that the present tax applies generally to all goods, with specified exemptions. Alternatively, the tax may be applied only to specifically designated services. For reasons of administrative efficiency, the second form of taxation appears to us to be preferable. While we do not suggest taxing all services, the disadvantages and inequity associated with their blanket exemption should, we believe, be corrected. The taxation of services being desirable in principle, each broad class of service must be examined to determine whether or not it would be just to tax it under the principles that we have developed, and whether or not the tax could be collected without undue administrative difficulty.

88. To meet the social objectives already discussed, all medical, dental and health services, funeral services, public transportation services and adult education courses conducted by school boards, universities or other non-profit organizations

should be exempt from sales tax. Services rendered to manufacturers or producers should likewise generally be exempt from tax, for the same reason as materials and machinery: to avoid double application of the tax.

89. If the tax is levied on all services, inevitable administrative problems arise in dealing with a large number of small service entrepreneurs. Further, serious conflicts arise as between the taxation of those types of services that can be rendered either by a service organization or by a single employee. For example, house-cleaning can be performed either by a service organization or by a domestic servant. Often, house-cleaning services are performed by one individual for a number of customers. It would thus be unrealistic administratively to attempt to collect tax on the services rendered by such a person. Consideration would also have to be given to the problem of services supplied through vending machines. Where such machines could not easily be adapted to collect small amounts of tax, the tax might become a burden of the business firms providing the services.

90. The determination of the particular services most appropriately subject to tax is a task best performed by government. We have developed, however, in accordance with the criteria that we have adopted, the following illustrative list of the types of services that we think should be taxed in addition to those already taxed as sales of tangible personal property:[6]

(a) Installation, repair and maintenance of taxable tangible personal property;

(b) Personal services including those rendered by barbers, hair dressers, beauty parlours, dressmakers, steam and sauna baths, driving and dancing schools, dry cleaners and laundries;

(c) Hotel, motel and other transient accommodation (defined as provided by an establishment having four or more rooms to rent and for which rent is paid for continuous occupation for less than one month);

(d) Automobile parking services (excluding metered street parking);

(e) "Pay" television, radio and music program services, and television cable services provided to subscribers;

(f) Amusements, theatrical and other performances, sporting events and recreational facilities; and

(g) Services in respect of transactions in real estate, stocks, bonds and other securities rendered by brokers, dealers and agents.

91. The inclusion of amusements, theatrical and other performances, and sporting events in the list is consequential upon the recommendation made in Chapter 31 that The Hospitals Tax Act be repealed and that expenditures now taxed under that Act be taxed under The Retail Sales Tax Act.

92. In Chapter 31 we also deal in detail with the proposal to tax services in respect of transactions in real estate and securities where we suggest that

[6]Rentals of tangible personal property, telephone service and long distance calls, telegrams, cablegrams and radiograms are already taxed.

the present special taxes on transfers be abolished and that instead sales tax be imposed on the commissions or deemed commissions that are incurred in making the transactions.

93. For the reasons given above, *we recommend that:*

The Retail Sales Tax Act be amended so as to impose tax on an appropriate list of services other than 29:9

- ***(a) educational, medical, dental, health, funeral and transportation services,***
- ***(b) services the dominant use of which is made by business firms,***
- ***(c) repair and maintenance of real property, and***
- ***(d) services that cannot be conveniently taxed.***

SUMMARY OF RECOMMENDATIONS REGARDING THE BASE

94. The effect of implementing our recommendations would be that the types of services outlined above, and all sales and rentals of tangible personal property would be taxed, except for the following categories of exemptions that we suggest should be retained:

- (a) food of all kinds,
- (b) commercially prepared meals sold for $1.50 or less,
- (c) children's clothing and footwear,
- (d) fuel oil, coal, coke, wood, natural and manufactured gas and electricity,
- (e) gasoline and other motive fuel used by farmers and commercial fishermen in the business of farming or commercial fishing,
- (f) farm implements, machinery and specific supplies, materials and equipment, fruit trees and food-producing shrubs and plants, and agricultural products including livestock,
- (g) trees sold by the Department of Lands and Forests,
- (h) aircraft engaged as common carriers,
- (i) natural water, including ice and steam,
- (j) clay, sand, gravel and unfinished stone,
- (k) boats, equipment and apparatus used by commercial fishermen,
- (l) commercial ships,
- (m) prescription drugs and medicines and appliances,
- (n) machinery equipment and materials used directly in the process of manufacture or production of tangible personal property for sale,
- (o) tangible personal property for delivery outside Ontario,
- (p) railway rolling stock and repairs thereto,
- (q) newspapers,
- (r) uncancelled Canada postage stamps purchased at prices not exceeding their face value,

(s) coins minted by the Royal Mint of Canada and purchased at prices not exceeding their face values,

(t) equipment, as defined by the Treasurer, purchased by a licensed fur trapper,

(u) tobacco products taxed under The Tobacco Tax Act,

(v) cut natural evergreen Christmas trees when used for decorative purposes,

(w) settlers' personal and household effects, and

(x) tangible personal property or specified services purchased at less than 11¢.

While the implementation of our recommendations would effect a worth-while reduction in the number of exemptions, the list of those that remain is nevertheless formidable. It will be observed that of these continuing exemptions, items (d), (e), (f), (h), (k), (l), (n) and (t) refer to goods that are commonly purchased for use in the process of production. The items included in (o) refer to goods sold to purchasers beyond the borders of Ontario. Items (i) and (j) are exempted because much of this material is used in the production process and, where this is not so, it would be exceedingly difficult and expensive to control the collection of tax. Item (p) is exempted because of the difficulty of determining the province that would be entitled to the tax, given that most of such rolling stock is operated more time outside the province than inside. Exemptions (v) and (x) are given for administrative and practical convenience. Items (a), (b), (c), (d) and (m) are maintained to make the tax less burdensome on taxpayers with low incomes, and item (q) exists because of inequity between similar items above and below the 11¢ exemption and because newspapers are worthy of public support. Exemption (u) applies as tobacco is now subject to a special tax under another Act. Item (w), the exemption for settlers' effects, parallels the exemption for federal customs duty and sales tax. The remaining three items that are exempted, (g), (r) and (s), relate to government activity. We are of the opinion that the reorganization of the exemptions according to these recommendations will greatly simplify the effective and equitable administration of the tax.

RATES

DIFFERENTIAL RATES

95. Although the provinces have the power to impose a lower rate of retail sales tax on socially desirable expenditures that they want to encourage, and to introduce a higher rate of tax on those expenditures considered to be of a non-essential or luxury class, none of them does so. Differential rates obviously are not neutral but discriminatory in effect. Moreover, they would introduce additional administrative problems to both the Retail Sales Tax Branch and to vendors. We therefore do not favour the introduction of differential rates of taxation in the Ontario Retail Sales Tax Act.

PROGRESSIVE RATES

96. We are of the opinion that rates progressively increasing with the dollar value of purchases, although theoretically possible, would not be suitable for a

retail sales tax. A progressive rate structure invites widespread evasion and therefore where desirable on other grounds, should be used only where the taxpayer has no substantial opportunity to avoid the tax or to pay it at a contrived lower rate. If such a tax were to apply to retail sales, then a person wishing to purchase a given dollar value of goods and services, for example, could reduce his tax by making his purchases in several separate transactions rather than at one time and place.

97. While both differential and progressive rates would probably produce additional revenue, we feel that neither is desirable or practical for a retail sales tax.

SCOPE FOR CHANGE

98. We believe that an expenditure tax with proper and adequate exemptions to control its regressive tendency is an equitable and effective means of raising provincial revenues. In making the foregoing recommendations for the revision of exemptions from the retail sales tax we have kept in mind that the rate of tax might at some time increase beyond its present 5 per cent. Quebec, New Brunswick and Newfoundland now utilize higher rates. It is therefore apparent that economic competition between provinces would not alone inhibit Ontario from raising its rate if necessary. We have no hesitation in advising the consideration of such an increase at such time as the over-all fiscal position of the Province is deemed to require an increase in tax revenues.

99. It should be noted that the sales tax is one major provincial tax that is not tied in with the federal tax structure. While most attention in the federal-provincial tax conferences has been focused upon personal and corporation income taxes, we believe that additional tax room could be made available to the provinces by a transfer from the federal sales tax area. This particular accommodation to the fiscal problems of the provinces is inhibited by two factors. First, the federal sales tax embodies a quite different base, which makes adjustments difficult. Second, one province, Alberta, has no sales tax. With these facts in mind, the Ontario government should negotiate with the other provinces and the federal government to achieve a uniform sales tax base, at the user or consumption level. In a word, it is obvious that the largest untapped source of federal tax room for the Province lies in the expenditure tax area. However, it should be recognized that the result of achieving such uniformity might be to give the federal government a dominating voice over the Province's sales tax base.

SOME ADMINISTRATIVE CONSIDERATIONS

ORGANIZATION OF STAFF

100. Most of the taxing statutes in Canada, including The Retail Sales Tax Act, are largely dependent upon voluntary self-assessment of tax by the taxpayers. However, an administrative staff that is competent to assist vendors who act as sales tax collectors and to interpret the statute and regulations is a necessary part of a successful retail sales tax. Poor accounting records, carelessness, and incorrect interpretations of the law and regulations, as well as attempts to defraud, make

it obvious that self-assessment by vendors is not sufficient. In order to protect the revenue, various enforcement measures are necessary. Adequate enforcement not only produces more revenue but also ensures equality of treatment between those vendors who honestly comply with all the provisions of the law and those who are less inclined to do so. Furthermore, by failing to enforce the taxing statute adequately, the Province not only loses a substantial amount of tax revenue but also permits unfair competition between vendors who collect the correct amount of tax and those who do not. This in turn creates feelings of frustration and contempt for the law.

101. The basic requirement for the effective enforcement of a retail sales tax is an adequate audit staff the size of which depends upon the extent of audit coverage desired. It could be argued that the audit staff should be increased until the marginal cost of an additional auditor equals the additional revenue expected to be recovered through his efforts, but we know of no jurisdiction that has actually adopted this approach. Judging from present difficulties facing the provincial government (as well as many other employers) in attracting skilled employees in sufficient numbers, we believe that such an objective is quite unrealistic, even if it were theoretically desirable. In the absence of any objective measure of the optimum size of the field audit staff, comparisons might be made with other jurisdictions that are thought to have reasonably adequate enforcement and audit programs.

102. We caution, however, that valid comparisons are most difficult to make, and for three main reasons. First of all, there are substantial variations in the responsibilities of audit staffs, even in jurisdictions maintaining separate audit and enforcement organizations. Second, the additional revenue resulting from retail sales tax audits depends upon the audit selection techniques used. Jurisdictions concentrating audits on "lucrative" accounts recover far more per audit than those that rely mostly on random sampling techniques. While in most jurisdictions audits are selected by both methods, the degree of emphasis varies substantially because of staffing problems and the differing philosophies of tax administrators. Finally, significant variations exist because of differing audit techniques. Some administrators rely upon brief checks while others require more detailed examinations. The existence of a high proportion of large industrial and commercial enterprises within a jurisdiction has considerable influence on the extent of the audits.

103. A highly respected authority on the retail sales tax, Professor John F. Due, has done considerable work in comparing the audit coverages of selected states in the United States.[7] It is apparent that he considers that only in the State of California does audit coverage come close to being adequate. In California, which has imposed the tax since 1930, on average each auditor performed 44 audits in 1959, and in all 11.6 per cent of the vendors were covered. In Professor Due's opinion, the optimum coverage with selective audit is difficult to define, but "study of audit programs in various states . . . suggests that at least 15

[7]John F. Due, *State Sales Tax Administration*, Chicago: Public Administration Service, 1963, pp. 129-30.

per cent of the accounts should be audited annually, with selection on as scientific a base as possible."[8] While it would not be fair to compare Ontario, at its stage in the use of the tax, with California, it is nevertheless interesting to note that Ontario would need 470 auditors to provide 15 per cent annual coverage of its 138,000 accounts at the rate of 44 audits per man-year. This contrasts with 207 auditors on Ontario's staff at December 31, 1966, which is nevertheless an impressive improvement over 1963 when there were fewer than 50. Ontario in the year ended March 31, 1967, conducted a total of 11,584 audits of all kinds, which on the basis of the average complement of auditors for the year, works out to about 56 audits per man-year. At this rate it would require a staff of 370 to provide 15 per cent annual coverage.

104. The value of an effective audit in terms of additional tax collected has already been amply demonstrated in Ontario, as indicated by the following figures:

	Nine months ended December 31	
	1966	*1965*
Number of audits and inspections	8,214	11,358
Percentage of vendors covered	6.1%	8.2%
Total tax recoveries	$4,281,198	$1,821,273
Average recovery per audit	$521	$160

We are informed that the average tax recovery per audit-hour for the year ended March 31, 1967, was $34, which is far more rewarding than the revenue from a public accounting practice!

105. There is little doubt that a sizeable increase in audit staff would be justified both in the additional revenue recovered from audits, and in the increased revenue that would flow from the monthly returns of vendors who have been audited consequential upon the review and correction of their procedures and practices. However, even if such revenue increases were not forthcoming, the resulting greater assurance of compliance is sufficient to justify an increased audit staff, for there is no equity in a tax that fails to achieve general compliance. *We therefore recommend that:*

> ***The Ontario retail sales tax audit staff be enlarged sufficiently to ensure an adequate enforcement program.*** **29:10**

REMUNERATION TO VENDORS

106. In common with the sales tax legislation of the other provinces in Canada, the Ontario Act provides for the payment of remuneration to vendors for their services in collecting and remitting the tax. While the Act provides for a separate arrangement to be made with each vendor, remuneration is in fact paid to vendors in accordance with ruling 1. This ruling sets out a series of rates based upon the

[8] Due, *Provincial Sales Taxes*, p. 147.

proportion of taxable sales to total sales, the average amount of each sale and the amount of tax collected. Where the tax collected does not exceed $40 the remuneration is $1. Otherwise the rate of remuneration is 2½ per cent of the tax collected up to $1,000 plus 1 per cent of the excess where the average value of the individual sales transactions is not over $1,000, or ½ per cent of the excess if such average value does exceed $1,000. These new rates of remuneration, effective April 1, 1966, provided payments to collectors of $5.9 million in the 1967 fiscal year, representing 1.5 per cent of the yield of the 5 per cent tax.

107. This remuneration is intended to compensate vendors for the costs involved in collecting the tax. While the rates set by Ontario are scaled in an attempt to match the amount of work involved, they are far from being an accurate measure of the actual costs incurred by vendors. Some vendors may receive more than adequate remuneration whereas others undoubtedly recover only a part of the costs they incur as tax collectors. Where the remuneration is less than such costs, this inadequate compensation is a constant irritant.

108. When the tax was first introduced, it was no doubt reasonable to pay vendors for what was a new and frequently expensive operation in their businesses, but we do not consider this reason to have validity at the present time. The original expense of new or modified equipment has been made and recovered and we feel that one of the normal costs of doing business in our contemporary society is the collection and remitting of taxes. Very few taxing statutes grant any remuneration to businesses for complying with the law, even though onerous responsibilities may be involved, and in our view such remuneration should not be granted in The Retail Sales Tax Act. While the acceptance of our recommendation may give rise to complaints at the time remuneration is discontinued, we doubt that the elimination of remuneration will create any significant hardship on the business community. *We therefore recommend that:*

> ***Ontario discontinue the payment of remuneration to vendors for the collection of the retail sales tax.*** **29:11**

LIABILITY OF VENDORS

109. The Act provides that taxes collected shall be deemed to be held "in trust", and until the tax is remitted there is a lien and charge on the assets of the vendor, in priority over all other claims and for the amount of the taxes collected. As it is written, it would appear that the provision applies only to tax actually collected by the vendor, but the Act also provides that where an assessment has been issued by the Comptroller, the taxes assessed shall be "deemed" to have been collected. While it seems proper to provide that tax actually collected should be held "in trust", it is difficult to see how tax not collected, for whatever reason, can be held "in trust". The most serious problem raised by this section, however, is the lien security created for the Province where, in the case of a bankruptcy, the lien apparently is in conflict with the priorities set out in the federal Bankruptcy Act. Where the tax has actually been collected and therefore is held in trust, the lien provision is quite proper. Accordingly *we recommend that:*

The Province be made a preferred creditor rather than a secured creditor with respect to sales taxes not collected by a bankrupt vendor but for which he has been assessed. 29:12

DETERMINATION OF FAIR VALUE

110. The Act provides that where the Comptroller of Revenue deems it necessary or advisable, he may determine the fair value of any property for the purposes of taxation under this Act. In the light of many decisions of the courts in cases involving the exercise of ministerial discretion in income tax matters, any objection will fail if there has been a proper exercise of discretion by the Comptroller on questions of value. Thus, there is no effective appeal against a determination of fair value by the Comptroller, unless it can be shown that he has proceeded without due regard for the facts or the law in the exercise of his discretion. Since there are no restrictions upon the circumstances that must be present before the Comptroller may exercise his discretion to determine that the value is other than the actual selling price, a very potent weapon is placed in the hands of the Comptroller. We have been informed that this provision has so far been used almost exclusively for the purpose of relieving taxpayers of tax in circumstances where the tax effect of a transition would otherwise have been unreasonably severe. While such a use of the section seems inoffensive on the surface, we think it undesirable for any civil servant to be in a position either to increase or decrease the tax when he sees fit. In our view the fair value of property on which a purchaser is taxable is a matter of fact which, in the event of dispute, should be decided by the proposed Board of Appeals or the Courts. *We recommend that:*

The provision in The Retail Sales Tax Act giving the Comptroller authority to determine the fair value of taxable property be repealed. 29:13

SPECIAL COLLECTION ARRANGEMENTS

111. A regulation under the Act requires the vendor to keep sufficient records and books of account to record the amount of sales of tangible personal property, the amount of tax collected, and the disposal of the tax. Since the retail sales tax is a direct tax, and must, as required by regulation, be shown as a separate item on each invoice issued, it is not a difficult matter for small and medium-sized vendors who maintain written records to account for the tax on the basis of the actual amount collected, and make their remittances accordingly. A serious problem exists for large vendors who because of the magnitude of their operations, high volume of transactions, or lack of sufficient accounting machines and equipment to process the accounting data quickly are not able to accumulate the required information by the specified monthly date for the filing of their return cards. This situation is especially common in businesses such as department stores and supermarkets, which have a high volume of low-priced items. As a result, many of these firms now are permitted to calculate their tax liability each month on a "formula basis" that has been approved by the Retail Sales Tax Branch, allowing them to meet the required monthly deadlines. There has been some reluctance by most

provinces to use this method of calculating the tax liability, because it approximates a form of indirect taxation such as a gross receipts tax, and thus appears to approach the borders of unconstitutionality. In Ontario, however, these vendors are subject to audit on the basis of the actual amount of tax collected, and thus the concept of direct taxation is preserved. We approve of this administrative technique and urge that its application be extended as far as possible, in the interest of relieving the burden on vendors. The administration should be encouraged to consider any other techniques, based upon industry statistics and ratios, which might permit other formula methods of reporting and remitting the tax collected.

STORAGE OF GOODS

112. Because the use of tangible personal property is one of the events that gives rise to tax liability, the definition of the word "use" is quite important in the Act. The term "use" is defined to include "storage and the exercise of any right or power over tangible personal property incidental to the ownership of that property. . . ." The term "storage" is, in turn, defined as including "any keeping or retention in Ontario for any purpose except retail sale or subsequent use outside Ontario of tangible personal property purchased from a vendor. . . ." It would appear that any person who purchased goods with the object of reselling them in the future could be held to be "storing" the goods, unless the goods were to be turned over at retail sale. Since "retail sale" is defined to mean "a sale to a purchaser for the purpose of consumption or use and not for resale", persons storing goods in Ontario with the intention of selling them to a retailer or to any other type of purchaser except a consumer would technically be required to pay tax on the goods so stored. This is clearly not the intention of the Act. *We recommend that:*

> ***The definition of "use" in The Retail Sales Tax Act be*** 29:14
> ***changed to exclude storage of goods that are held for resale.***

NON-RESIDENT CONTRACTORS

113. The Act requires a non-resident contractor, carrying out a contract in Ontario, to deposit with the Treasurer an amount equivalent to 3 per cent of the contract price or, alternatively, to furnish a guarantee bond in the same amount. The deposit is refunded or the bond released at the completion of the project, but only after the contractor's records have been audited and all taxes due on material brought into the province have been paid. That on average the 5 per cent tax on the materials used in construction is probably less than 3 per cent of the contract price is evidenced by the Treasurer's power to rebate to the governing body of a religious, charitable or benevolent organization 2.1 per cent of the total contract price for a building or other structure as an approximation of the 5 per cent tax on the materials. It therefore appears that the deposit demanded of non-resident contractors is on average nearly one and one-half times the tax that would be payable even in the unlikely circumstance that all the materials were purchased outside Ontario. *We therefore recommend that:*

The deposit or bond of 3 per cent of the total contract price required of non-resident contractors carrying out a contract in Ontario be revised to relate more closely to the proportion of construction contract prices ordinarily represented by sales tax. **29:15**

114. A non-resident contractor is defined as an individual or corporation who has not maintained continuously in Ontario, for a period of twelve months immediately preceding the signing of any particular contract, a permanent establishment as defined in The Corporations Tax Act. Under this definition a construction firm incorporated in Ontario within twelve months preceding the signing of the contract would be classed as a non-resident contractor, and therefore unjustly subject to the deposit requirements. *We therefore recommend that:*

The definition of non-resident contractors be changed to exclude corporations that are incorporated in Ontario. **29:16**

RENTALS

115. The percentages of the rent to which tax applies when tangible personal property is leased are set out by regulation. Rentals for any period up to and including six days are charged on 100 per cent of the rental price. For a period of more than six days but not more than one month the tax is levied on 90 per cent of the rental, and for periods in excess of one month, on 80 per cent. The reduction in taxable rental price is designed to allow for the service and interest factors built into the rental charges. However, since we have recommended the taxation of certain services, these reductions should be reviewed to make sure that they are on average no greater than the proportion of rentals represented by property and services taxed to the lessor and interest. *We therefore recommend that:*

Rentals of tangible personal property be taxable except on the amounts provided therein for **29:17**

(a) property and services on which the lessor was subject to tax, and

(b) interest and other financing costs.

GIFTS

116. The Act presently exempts tangible personal property received by bequest or received from a member of the recipient's family without payment of any consideration. For this purpose, a member of his family means his father, mother, husband, wife, grandfather, grandmother, son, daughter, grandson, grand-daughter, son-in-law, daughter-in-law, father-in-law or mother-in-law. We are of the opinion that this definition is too restrictive, in that gifts between brothers, sisters, aunts, uncles, nephews, nieces, cousins, and unrelated persons remain taxable. It is our opinion that all gifts from one individual to another should be free of tax. It is now a reasonable assumption that most articles of value that might be given were

subject to sales tax when acquired by the donor. In any case, the administrative impossibility of adequately enforcing the payment of sales tax on gifts strongly indicates that the present law should be changed. We also believe that the exemption should be expanded to include the element of gift involved in transactions where the consideration is less than fair value. *We therefore recommend that:*

The present exemption for gifts be enlarged to exempt from retail sales tax all gifts from one individual to another, including those made by way of transactions for inadequate consideration. **29:18**

INTERPROVINCIAL TRANSACTIONS AND IMPORTS

117. Sales made by vendors where the goods are delivered outside the province are not subject to tax, as these goods are neither consumed nor used in Ontario. Loss of revenue to the Province is experienced, however, when goods are purchased outside Ontario and brought into the province for consumption or use. The onus then is on the purchaser who brings the goods into Ontario to remit the tax to the Retail Sales Tax Branch, but all too often this requirement is not met. Many out-of-province vendors, who regularly sell in Ontario, have voluntarily obtained Ontario vendor permits, and collect and remit the Ontario tax on all sales where the goods are delivered in Ontario. Many still do not. The Regulations require a person who does not hold a vendor's permit to obtain a special certificate from the Branch if he "solicits orders in Ontario for the sale of tangible personal property which is to be shipped to the purchaser in Ontario from a point outside Ontario". So that the Branch can ensure collection of tax, the holder of a special certificate is required to file a monthly return with the Branch containing the name and address of each person from whom an order has been obtained, and a description of the goods to be sold, as well as the selling price, the date the order was taken, and the estimated date of delivery in Ontario. It is difficult to enforce this regulation.

118. Early in 1963, the Province of Quebec amended its Retail Sales Tax Act to require all vendors, wherever located, to acquire a Quebec licence and collect tax on behalf of Quebec if they solicit orders from and deliver movable property to residents of Quebec. But because the provincial courts will not enforce the revenue laws of another province, this provision is without effect. In order to overcome the problem, the Province of Quebec enacted further legislation requiring the Quebec courts to enforce the revenue laws of any other province that enacts reciprocal legislation. While the constitutionality of this Quebec legislation is questionable, it represents an important first step, in that it indicates the willingness of one province to negotiate with others about the means of overcoming one of the serious problems of provincial tax administration.

119. We think that the only complete solution for the provinces would be for each of them to require its resident vendors to collect tax on sales of goods delivered outside of the province to non-residents. The vendors would be required by the province in which they were located to report and remit their tax collections to it giving a summary according to the provinces to which the goods were delivered.

The collecting province would then make a monthly settlement with each other province. Because of the difficulties inherent in requiring vendors to collect at the rates and on the bases of the laws of the nine provinces now imposing the tax, it might be better to collect the tax as imposed in the province where the vendor is located. Such an arrangement would perhaps require a constitutional amendment as the effect would be for the vendor's province to tax persons who are not resident, even though the revenue from the tax would be turned over to the provinces in which such persons are resident.

120. Ontario has worked out an arrangement with Quebec for the exchange of information, obtained through their retail sales tax audits, regarding sales made in one province for delivery in the other. We think that pending a comprehensive solution like that described in the preceding paragraph, similar arrangements should be made with other provinces. Because of the small coverage of sales tax audits, information would be provided regarding only a relatively small portion of interprovincial sales. Nevertheless, public knowledge of such arrangements should have a salutary effect on the conduct of purchasers who might otherwise be tempted to forget about their sales tax obligations to the province in which they reside. As a means of determining what vendors make substantial interprovincial sales, Ontario should consider requiring vendors to report the total amount of such sales. *We therefore recommend that:*

The Government of Ontario negotiate with the other provincial governments to establish more effective means of collecting sales tax on goods sold in one province that are delivered to customers in another province. **29:19**

121. There remains the further problem concerning goods brought into Ontario from outside Canada. We suggest that Ontario and all the other provinces imposing retail sales tax should negotiate with the federal government with a view to having the Customs and Excise Division of the Department of National Revenue act as agent for the provinces in the collection of retail sales tax. *We therefore recommend that:*

The Government of Ontario, together with the other provincial governments, negotiate with the federal government to obtain its agreement to collect on behalf of the provinces provincial sales taxes upon the importation of goods into Canada. **29:20**

SUMMARY AND CONCLUSIONS

122. From our analysis, we can draw some conclusions about the merits of the Ontario retail sales tax. We have indicated our belief that this tax is borne by consumers, in rough proportion to their expenditure on taxable items. If this assumption is correct, many of the present exemptions have merit. In addition, we have illustrated that the burden of the existing retail sales tax is approximately

proportional to family income. We have also shown that the tax would be more regressive if we included food in the tax base and even more so if all expenditures were included. The inclusion of food, combined with a rebate system, would make the tax slightly less regressive than currently, but we believe that the net gain in equity is not sufficient to recommend such a complicated rebate plan. In general, we are reasonably satisfied with the distribution of the burden of the Ontario tax, if amended as we have recommended. Although we believe that the total tax system should be progressive, taxes other than the retail sales tax are better structured to refine the progressivity of the system.

123. We believe that at the present rate of 5 per cent, the amended tax is unlikely to cause any widespread undesirable economic effects. Two generalizations may be offered to lend support to the use of the retail sales tax.

124. The first is that the distortions in the economy that result from any tax tend to become more and more significant as the tax rate rises. It is therefore likely that economic resources will be allocated in a more efficient manner if there are several different taxes, each levied at a relatively low rate, than if only a few taxes are levied at high rates. In this connection, incomes are currently taxed at relatively high rates, and it is difficult to tax wealth except through succession duties and the property tax. This being so, when additional provincial revenues are needed, it seems reasonable to use an expenditure-based tax. Of the various forms of expenditure taxes, the retail sales tax appears to be the best alternative available to the Province.

125. Second, given the present structures of income and sales taxes in the provinces of Canada and in the states of the United States, it appears that the economic goals of Ontario can better be furthered by a greater use of the retail sales tax than by exclusive reliance on increases in corporate or personal income tax rates. If the Ontario corporate tax rate were to be raised to a level significantly above those in other provinces or in the neighbouring states, the industrial growth of the province might suffer markedly. The effects of higher personal income tax rates would not likely be as evident, but there might well be a tendency for firms that employ a large number of high-salaried personnel to shift their businesses outside the province.

126. We believe that some of the existing exemptions from the retail sales tax are justified. In particular, we believe that food should continue to be exempt and that the exemption for producer goods should be broadened wherever administratively possible. However, the list of other exemptions should be reduced.

127. Finally, we strongly advocate the inclusion in the tax base of as many of the consumer services that do not enter into the costs of taxable goods as is administratively feasible. The inclusion of these services will not only make the tax more equitable but also allow given amounts of revenue to be obtained at significantly lower tax rates.

Chapter 30

Motor Vehicle Revenues

INTRODUCTION

1. Our purpose in analysing motor vehicle revenues is to judge the propriety of the share of road costs now borne by road users and to evaluate the efficiency and equity with which these charges are assigned to the various categories of motor vehicles. To accomplish this, we review the current sources and distribution of motor vehicle revenues and then examine these in relation to road costs. Of necessity, a number of our conclusions rely for their validity on certain analytical conventions or assumptions that underlie the theoretical and professional writing on this subject. None of these conventions offends common sense, and all have been carefully reviewed in the light of alternatives, before being adopted for the analysis which we develop in this chapter.

2. In as specific a manner as possible, we attempt to relate road-user charges to the road benefits each user receives. This is not, unfortunately, as straightforward an approach as it might at first appear, nor is it an approach that can be justified absolutely. There are two main difficulties: one is the problem of identifying, conceptually and practically, the actual benefits that we claim each

road user receives, and the other is the conflict that may arise between a scheme of road-user charges based on road-user benefits and the particular scheme of charges that would allocate road services in the economically most efficient way. Our general approach, one that is commonly used and accepted, is to divide the beneficiaries of road services into two groups, road users and others. A certain portion of road costs is assigned to road users and this portion must be met completely by motor vehicle revenues. Within this over-all constraint, the various tax and permit arrangements should allocate motor vehicle charges among the various classes of motor vehicles, and even among individual motor vehicles, according to the road costs that each vehicle or class of vehicle occasions. Benefits received are roughly identified with the costs of the services deemed to benefit road users. The potential conflict between the efficient allocation of road services and our system of road-user charges that completely cover the road-user portion of road costs remains unreconciled. Implicitly, if not explicitly, the assumption in the standard literature on the subject is that a system of road-user charges based on benefits received will be tolerably efficient, or at least that no better system could easily be devised. When the pricing system for all modes of transportation is taken into account, as it should be, the assumption appears quite reasonable and unlikely to lead us seriously astray.

3. The real significance of this method of judging the allocation of road costs can probably be better understood if, rather than delving into the details of charging according to benefits received, we point out one of its basic implications. This is that fuel taxes and other fees for the use of roads are not regarded as instruments designed to achieve a deliberate redistribution of income. Other taxes, primarily those on personal income, have this as one of their functions and are much better suited to the purpose. We do, it is true, discuss the incidence of motor vehicle charges, but our interest here, in this chapter at least, is solely descriptive. In the over-all view of government taxation, however, motor vehicle charges are among the levies imposed upon the population and these necessarily influence, although perhaps only slightly, the redistributive schemes that are ultimately enacted.

4. Before turning to an analysis of motor vehicle revenues in relation to road costs,[1] we shall describe the various road revenue sources in Ontario, making recommendations for changes where appropriate. This description provides a desirable background for the later discussion, even though it is not wholly independent of the results of the final sections of the chapter. For example, fuel taxes are discussed in the section immediately below, but it is not until the final section that we can bring certain parts of the analytical framework to bear on the question of whether the taxing of motive fuel is in fact an appropriate way to charge for the use of roads.

[1]In some parts of the United States, motor vehicle revenues are earmarked for spending on roads. Although this is not done in Ontario, where motor vehicle revenues are simply put into the general revenue fund, it is clearly appropriate to consider these revenues to be the contribution of road users toward road costs.

FUEL TAXES

5. Because of the obvious relationship between road use and taxes paid, a tax on fuel used in motor vehicles is an intuitively attractive way of raising revenue to meet road costs. In addition, such a fuel tax is relatively simple to administer. As a result of their attractiveness and simplicity, fuel taxes currently constitute about three-quarters of all motor vehicle revenues. This share has only twice been below 70 per cent in the last twenty years.

6. Whether a fuel tax allocates road costs appropriately among different types of motor vehicles, or whether such a tax is economically efficient in the sense of charging each motor vehicle operator an amount equal to the additional road and other costs resulting from his driving an extra mile, are more complex questions to which we turn in the last section of this chapter. For the moment, we assume simply that fuel taxes are among the levies set for the use of roads and that vehicles of similar weight and size should pay roughly similar amounts in fuel taxes per mile driven.

RATES AND ADMINISTRATION

7. The gasoline tax was introduced to Canada by the Province of Alberta in 1922. Three years earlier the State of Oregon had been the first to tax gasoline in the United States. In 1925, Ontario joined Alberta, as had also by that time Manitoba, British Columbia, Prince Edward Island and Quebec, in this readily accessible tax field. By 1928, all provinces had established a gasoline tax. The rates in these early years, and their evolution to the present, are shown in Table 30:1. According to the 1966-67 provincial budget estimates, the current gasoline and diesel-fuel taxes in Ontario will yield $275 million.

TABLE 30:1

TAX RATES ON MOTOR VEHICLE FUEL, SELECTED YEARS

(in cents per gallon)

	Initial rate (and year)	*1939*	*1949*	*Gasoline 1966*	*Diesel fuel 1966*
Newfoundland	—	—	14	19	19
Prince Edward Island	2 (1924)	10	13	18	18
Nova Scotia	3 (1926)	10	13	19	27
New Brunswick	3 (1926)	10	13	18	23
Quebec	2 (1924)	8	11	16	22
Ontario	3 (1925)	8	11	16	22
Manitoba	1 (1923)	7	9	17	20
Saskatchewan	3 (1928)	7	10	15	18
Alberta	2 (1922)	7	9	12	14
British Columbia	3 (1923)	7	10	13	15

Source: Roger E. Carswell, *Taxes and Traffic*, Toronto: Canadian Tax Foundation, 1955; and Dominion Bureau of Statistics, *The Motor Vehicle* (Annual), Part I, "Rates and Regulations".

8. Until 1957, gasoline and diesel fuel for road use were taxed at the same amount per gallon. In Ontario in 1957, when gasoline was taxed at 13¢ a gallon, the rate on diesel fuel was raised to 20¢ a gallon. This increase was made in recognition of the greater fuel efficiency of diesel engines and in accordance with the principle that similar vehicles should pay similar fuel taxes for a given distance travelled. Ontario was the first province in Canada to differentiate in this way between the rate on gasoline and the rate on diesel fuel. Subsequently, all provinces except Newfoundland and Prince Edward Island followed Ontario's lead.

9. In an effort to determine more precisely the appropriate spread between the two rates, the Ontario Department of Transport began in 1957 a study of the relative efficiency of gasoline and diesel fuel in a variety of tractor-trailer trucks and buses over short and long hauls. In 1958, the Department reported[2] that the average consumption of gasoline for a given distance exceeded the consumption of diesel fuel by a factor of 1.47. However, the tractor-trailer trucks, taken as a group, showed a lower relative gasoline consumption than this average, and because the analysis of relative consumption in this group was felt to be more reliable than the analysis of relative consumption in buses, a factor of 1.42 was ultimately recommended. This the government accepted and immediately lowered the tax on diesel fuel to 18.5¢ per gallon.

10. Shortly after Ontario raised the gasoline tax to 15¢ a gallon in 1964, the diesel-fuel rate was raised to 20.5¢ a gallon, and the 1966 increase in gasoline tax to the present 16¢ per gallon was accompanied by a raise in the rate for diesel fuel to 22¢. Thus, although these recent ratios of diesel-fuel tax to gasoline tax have slipped slightly below the recommended 1.42,[3] the general principle that the fuel taxes are distance taxes has become well established. This principle does not, of course, overcome all the difficulties involved in attempting to tax, at appropriate amounts per mile driven, vehicles of completely different weights, or even similar vehicles travelling at different speeds, but it does provide a relatively easily determinable rule of thumb for setting tax rates on different motor vehicle fuels, such that the fuel tax per mile is approximately equal for similar vehicles. In our view, future taxes on any fuel used to propel road vehicles should continue to be set according to this principle.

11. The Gasoline Tax Branch of the Ontario Treasury Department administers the two Acts under which gasoline and diesel fuel are taxed, The Gasoline Tax Act and The Motor Vehicle Fuel Tax Act. As defined by the former, "gasoline includes aviation fuel and any gas or liquid produced, prepared or compounded for the purpose of generating power by means of internal combustion or that may

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[2]Ontario Department of Transport, Research Branch, *Report on the Diesel Fuel Tax in Ontario*, Toronto, March 1958.

[3]This is perhaps justifiable, in view of the comment in the 1958 Report that the vehicles in the study using gasoline were generally older than the vehicles using diesel fuel, and that the average relative consumption of gasoline might therefore be expected to drop somewhat as the age structure of the two types of vehicles became more similar.

be used for such purpose."[4] Fuel subject to The Motor Vehicle Fuel Tax Act is defined as "any gas or liquid that may be used for the purpose of generating power for the propulsion of a motor vehicle", except for gasoline, aviation fuel, jet fuel, turbo-jet fuel, bunker fuel, liquefied petroleum gas and other such fuels.[5]

12. Although these fuel taxes are in general easy to compute, collect and control, the administrative process is complicated somewhat by the exemptions and refunds provided for the non-road use of fuels, especially of diesel fuel, only a small portion of which is used in motor vehicles. Instead of taxing all fuel coming under The Motor Vehicle Fuel Tax Act and then refunding the non-taxable portion, as is generally done with gasoline, the government attempts to levy tax on only the diesel and other fuel oil that is used in motor vehicles. This has meant that in an effort to reduce evasion of the tax, an extensive system of reporting has been devised, with penalties set for failure to give accurate information to the Province. In a further attempt to reduce tax evasion Ontario has recently enacted legislation providing that motor fuel sold for non-taxable purposes will be coloured purple.

13. Under The Gasoline Tax Act, every person selling or delivering fuel in Ontario to a consumer must collect the appropriate amount of tax. In addition, Section 1(1) of the Regulations under the Act requires persons selling or delivering gasoline to a purchaser to collect the tax and to pay it over to "collectors" who are authorized to act as agents of the Minister. These collectors, about fifty in number, are normally oil companies and they collect the tax from retailers, mainly service station operators, on the basis of the amount of gasoline delivered, and then remit the tax to the government. For this service collectors are remunerated at a rate of 1/10¢ per gallon. The Province also makes a payment to the retailers licensed to sell gasoline at the rate of 1/30¢ for each gallon on which tax is paid to a collector. This payment is to compensate the retailers for the tax paid to collectors on gasoline that is lost owing to shrinkage in the tanks.

14. The persons collecting tax under The Motor Vehicle Fuel Tax Act are called "registrants". The first category of registrants comprises oil companies that sell fuel to consumers. In the second category are large users of fuel who pay the tax directly to the government. They may use fuel for both taxable and non-taxable purposes, but they pay tax only on the fuel used in motor vehicles, instead of paying it on the full amount delivered and then filing for a refund on the portion used for non-taxable purposes. Registrants in the first category are remunerated at a rate of 2.5 per cent of the tax collected. Registrants in the second category receive no compensation as they remit only the taxes on fuel consumed by them.

15. In our earlier discussions of the sales tax we maintain that persons should not be compensated for collecting taxes on behalf of the government. The present system of compensating some firms and individuals for some of the taxes collected suggests the difficulties involved in any attempt to provide equitable remuneration

[4] R. S. O. 1960, c. 162, s. 1(b).

[5] R. S. O. 1960, c. 248, s. 1 (b), and *Revised Regulations of Ontario, 1960*, Regulation 449, as amended.

for tax collecting. Moreover, it is the duty of citizens, we believe, to aid in the collection of taxes. *We therefore recommend that:*

> ***The remuneration for collecting fuel taxes paid to "collectors" under The Gasoline Tax Act and to "registrants" under The Motor Vehicle Fuel Tax Act be gradually eliminated over the next five years.*** **30:1**

A SALES TAX ON FUELS

16. Before returning to a more detailed discussion of fuel tax exemptions and refunds, we wish to consider the exemption from sales tax that gasoline and diesel fuel currently enjoy under The Retail Sales Tax Act. This exemption is somewhat unusual in that it fits into none of the normal categories of exemptions. A sales tax on motor vehicle fuels would not be extremely regressive, as a tax on housing or a tax on food is, nor would it be especially complex to administer—and these are among the usual grounds on which exemptions are justified.

17. The fact that there already exists a provincial tax on motive fuel does not constitute an argument against levying a sales tax on this commodity. Fuel taxes are contributions made by road users towards the cost of building and maintaining roads, while the sales tax is a general levy related mainly to the retail purchase of consumers' goods and intended to help meet general government expenditures on the public's behalf. There is no reason why consumers of gasoline and diesel fuel should not contribute to the general expenditures of the Province in the same manner as consumers of any other product that is subject to the sales tax.

18. If a sales tax is to be levied on motive fuels, should the base for the tax include or exclude the fuel tax? Some might argue that to include the fuel tax in the sales tax base would be unjust because the Province is then taxing a tax. But that is simply a statement of fact, not an argument. The fuel tax is, quite clearly, a part payment for the use of roads, a service that the government provides to readily identifiable beneficiaries. Thus the purchaser of motive fuel buys both a commodity, the fuel, and a service, the use of public roads, and we believe that it is equitable to levy a sales tax on both these components. Such a tax on tax would by no means be without precedent in Canada. The federal sales tax is now levied on a base that includes, in some cases, both import duties and excise taxes.

19. It cannot be denied that the imposition of a sales tax on a price that includes a motor vehicle fuel tax would introduce a number of inconsistencies. Only part of the road users' contribution to road service costs would then be subject to a sales tax, for the smaller part paid through the purchase of licences and the payment of fees would not be taxed. Furthermore, other specific government services provided for identifiable individuals are not subject to a sales tax. Finally, some of the sales tax would be imposed on fuel used in commercial vehicles, and we have agreed that in general the sales tax should not be placed on such intermediate or producers' goods. In this particular case, however, we feel that administrative considerations are sufficiently important to provide a defence for breaking our general rule against placing the sales tax on such goods. In our view,

other inconsistencies are not sufficiently great to vitiate the argument for imposing a sales tax on the fuel-tax-inclusive price of motive fuel.

20. To eliminate the complexity of having two Treasury Branches engaged in administering taxes on motive fuel, responsibility for collecting the total tax on these fuels could reasonably remain with the Gasoline Tax Branch. The sales tax portion of the total receipts would, however, be included in government accounts as sales tax receipts. Under such a scheme, the sales tax would be levied under The Retail Sales Tax Act as a percentage of sales in the ordinary manner. To effect a combined rate per gallon, the gasoline tax, for example, would then be levied at a rate defined as, say, 18.5¢ per gallon less the retail sales tax on the sale. The purchaser would pay 18.5¢ per gallon of combined tax. The computation of the sales tax component of the yield from the combined rate would be made internally by the administration.

21. In accordance with the foregoing, *we recommend that:*

The retail sales tax be levied on gasoline and other motive fuel, on a price base that includes any fuel tax that is applicable. **30:2**

FUEL TAX EXEMPTIONS AND REFUNDS

22. Over the years since the gasoline tax was first introduced in 1925, there has been a changing list of motive-fuel uses for which the full fuel tax has not been assessed. For most uses on this list, the tax is first paid and later wholly or partially refunded on the receipt of an application from the purchaser. An exception, as noted above, is that registrants under The Motor Vehicle Fuel Tax Act generally pay no initial tax on diesel and other fuel oil used for off-highway purposes. The refund system has been operating since 1925, when full refunds were granted on fuel used for purposes other than propelling a vehicle on any highway. In 1929, full refunds were extended to the municipally owned commercial vehicles of cities and separated towns. The list was shortened in 1935, when refunds to contractors for fuel used in vehicles engaged in highway maintenance and construction were discontinued. In 1947 the list was again shortened, when municipally owned commercial vehicles as well as municipally owned road maintenance and road construction equipment were removed from the list of tax-refundable uses. For a brief period, between July 1943 and October 1945, farmers, fishermen, tourist guides and tourist outfitters were completely exempt from paying even a refundable fuel tax. In 1957, full refunds were extended to the federal government for all uses and continued for purchasers of fuel for farming and commercial fishing. All other claimants received only an 11¢ refund from the prevailing 13¢ gasoline tax. Full refunds were granted for off-highway use of diesel and other fuel oil.

23. The disarray of fuel tax exemptions and refunds that was evident in 1957 has, if anything, increased in recent years. Currently, full gasoline tax refunds are given for federal government consumption, an exemption for which we see no grounds in equity and which we therefore think should be terminated as soon as

practicable. Full refunds are also granted for commercial fishing and for off-highway farm use. All other off-highway users of taxable fuels under The Gasoline Tax Act are granted refunds of 13¢ per gallon, except that aviation fuel carries a tax of 2¢ a gallon, charged at the time of purchase. Any tax paid on a taxable fuel under The Motor Vehicle Fuel Tax Act is fully refundable if the fuel is used for purposes other than propelling a vehicle on any highway. Fuel used in equipment engaged in road work is taxable.

24. The 13¢ refund to boat owners and other off-highway consumers has been granted since 1964, when the gasoline tax was increased to 15¢. With the tax increase to 16¢ in April 1966, the ultimate tax paid by this group rose from 2¢ to 3¢. The tax retained on aviation fuel nevertheless remained at 2¢, its level before 1966. Prior to 1963, purchasers of aviation fuel paid the full tax and then applied for a refund at the same rate as boat owners and other off-highway users. From 1963 to 1966, these purchasers paid only the difference between the full tax and the refund permitted the off-highway consumers, which in that period was 2¢.

25. In order to receive a refund, a purchaser of gasoline or other motive fuel must forward an application to the Treasury Department, along with a properly receipted invoice, within six months of the date the invoice was paid. The current magnitude and distribution of these refunds are shown in Table 30:2, where it

TABLE 30:2

REFUNDS OF GASOLINE AND MOTOR VEHICLE FUEL TAXES FOR THE FISCAL YEAR ENDING March 31, 1965

	Number of claims	*Value (thousands of dollars)*	*Percentage of total*
Commercial fishing	755	72	0.4
Contractors	2,005	511	3.1
Farmers	137,947	11,658	71.0
Federal government	78	42	0.3
Industrial	8,419	1,972	12.0
Lumbering	1,011	738	4.4
Marine	34,887	646	4.0
Mining	83	31	0.2
Municipalities	126	35	0.2
Public utilities	97	81	0.5
Pumping units	788	110	0.7
Railways	105	132	0.8
Tourist camps	1,336	249	1.5
Remuneration to service stations	3,774	149	0.9
Total Refunds under The Gasoline Tax Act	191,411	16,426	100.0
Motor Vehicle Fuel Tax	323	177	
Total Refunds	191,734	16,603	

Source: Ontario Treasury Department, Gasoline Tax Branch.

can be seen that farmers receive more than 70 per cent of the money refunded under The Gasoline Tax Act. Although the refund process involves a certain amount of cost and inconvenience, it is probably administratively simpler than the alternative of permitting consumers to buy gasoline wholly or partially tax free for off-highway uses, and it undoubtedly involves less tax evasion.

26. Over the years since the gasoline tax was introduced in Ontario, it has generally been recognized, although not always reflected in refund policy, that this tax was intended to apply to motive fuel for road use. To apply this principle consistently would be to exempt fully from the gasoline tax all fuel that was not for road use. It is true that the refund process associated with any partial or full exemption involves some costs of administration, and it might be suggested that the currently widespread partial exemption is therefore more appropriate than a full exemption. However, it seems more to the point to argue that these administrative costs occur because gasoline is taxed in the first place and that they should therefore not be borne by those who were incorrectly taxed initially.

27. We have concluded that all sales of motive fuels for off-road use should be entirely exempted from fuel taxes. With the exception mentioned below, these sales should, however, be subject to sales tax on the price of the fuel. Fuel purchased by farmers and commercial fishermen should be entirely exempt from tax, as are electricity, natural gas and other forms of power used by other producers. Whether fuel for these purposes is exempt or subject to refund of tax is a matter of administrative efficiency on which we will remain silent except to mention that the following recommendation is phrased in accord with the assumption that the refunds will continue as the dominant device. *We recommend that:*

Any fuel tax paid on motive fuel for any use other than that of propelling a vehicle on a public road be wholly refundable, and any sales tax thereon **30:3**

(a) be wholly refundable when paid by farmers or commercial fishermen, and

(b) be refundable to the extent based on the refundable amount of fuel tax when paid by others.

CONSTITUTIONALITY

28. Section 92 of The British North America Act, 1867, restricts provincial taxation to "Direct Taxation within the Province in order to the raising of a Revenue for Provincial Purposes". Largely because "direct taxation" cannot be unambiguously interpreted, the constitutionality of provincial taxes levied on the consumption of gasoline, or on other consumables like tobacco, has in the past been challenged. The Province's right to levy such taxes has been sustained on what may be called a common-sense application of John Stuart Mill's distinction between direct and indirect taxes. Mill defined a direct tax as one whose burden is borne by the person on whom it is initially imposed, an indirect tax as one whose burden could be shifted. The Courts have accepted this definition as expressing the controlling principles for ascertaining whether a tax is or is not a direct tax.

29. This common-sense approach is applied in three ways. The first is by looking at the question of "direct or indirect" in terms of a general tendency rather than in terms of individual cases, with the result that a tax levied in a certain area is considered in law to be either wholly direct or wholly indirect.[6] The second is by dealing with consumption at the level of retail sale and purchase, so as to minimize the circumstances in which the tax on the purchaser will be one that he will pay as part of a business operation in which he is engaged, and thus one that will ordinarily be passed on, in some degree, to a customer in the course of the business.[7] The third application of common sense lies in the careful attention given to drafting the correct use of terms and formulas in order to emphasize that the tax is levied on the consumer and that the responsibility of the retail seller is not to bear the burden of the tax but to collect its proceeds as an agent for the government.

30. Once it is clear in provincial legislation that the gasoline tax is being imposed on a retail purchaser, there appears to be little likelihood of its being held to be invalid merely because some of the persons taxed are consumers who are engaged in a business operation that would normally be expected to recoup the cost of gasoline, including the tax, in the prices charged to customers of the business. Nor is it likely that such persons would be able to establish that they were exempt from the tax unless they were declared to be exempt in the statute or in the regulations. For example, the fact that some consumers who purchase at retail are in the trucking business would not give them an exemption unless by express provision. By refraining from making the retailers of gasoline primarily liable for the tax, the provinces settle the constitutional question in their favour. For administrative convenience, oil companies and retail vendors may be used as tax collectors, but in this capacity they are simply Crown agents. Whether or not they are paid for their duties as agents has no bearing on the constitutionality of the tax. Expert legal opinion holds that the Province is entitled to include enforcement provisions in its otherwise valid legislation. Granted the validity of a consumption tax, legislative direction for its collection by persons best situated to do so is mere machinery to implement the taxing measure.

LICENCES AND PERMITS

31. In addition to fuel taxes, the Province levies fixed charges over specified periods—frequently annually—for various licences and permits required of the motor vehicle owner and driver. These licences and permits are necessary for regulatory and administrative purposes, but the fees for some of them are set sufficiently high to yield considerable net revenue. This revenue may be considered an additional contribution by motor vehicle owners toward the cost of building and maintaining roads in the province, for various forms of traffic control and for other associated benefits.

32. Later in this chapter we discuss the appropriate proportion of road costs to be assigned to different classes of motor vehicles, and in that discussion the amount

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[6]See, for example, *Cairns Construction Ltd.* v. *Government of Saskatchewan,* [1960] S. C. R. 619; 24 D. L. R. (2d) 1.

[7]See, for example, *Atlantic Smoke Shops Ltd.* v. *Conlon and Attorney-General for Canada,* [1943] A. C. 550.

of revenue to be raised through licence fees is an important element. In this section, where we review the existing rate structure for licences and permits, we base our analysis on the simple principle that vehicles of similar type and weight should be charged similar fixed fees for revenue purposes, without attempting to determine the appropriate level of these fees. Charges for regulatory purposes may be made in addition, but purely regulatory charges should not be expected to produce net revenue for the Province.

33. The magnitude of fixed licence charges, and even the economic propriety of using fixed charges to raise revenue, are issues of contention in the theoretical literature. By way of justification, these fees are generally regarded either as a contribution toward overhead road costs, which are independent of traffic volume, or as an adjustment to distance levies such as the fuel tax, the objective being to bring total payments for road use by any one class of vehicle into line with road costs incurred on its behalf. Our adherence to the principle outlined in the preceding paragraph does violence to none of the views on the magnitude of fixed charges while allowing us to avoid becoming embroiled in the controversy at this stage.

34. Permits and licences are administered by the Ontario Department of Transport under authorization of The Highway Traffic Act, The Public Commercial Vehicles Act and The Public Vehicles Act. Certain licensing responsibilities under the last two Acts are undertaken by the Ontario Highway Transport Board. During the fiscal year 1966, fees (including fines) received by the Department of Transport from the sources shown in Table 30:3 totalled almost $96 million. Over 90 per cent of this total was derived from permit charges for vehicles and licence fees for

TABLE 30:3

DEPARTMENT OF TRANSPORT REVENUE FROM PERMITS, LICENCES, FEES AND FINES
FISCAL YEAR 1966

	(thousands of dollars)
Passenger vehicle permits (including station wagons)	46,444
Truck and tractor permits	27,467
Trailer permits	7,043
Bus permits	1,138
Motorcycle permits	313
Public Commercial Vehicle operating licences	3,792
Public Vehicle operating licences	326
Operator and chauffeur licences (including learners' permits)	4,615
Dealer licences	109
Garage licences	335
Transfer fees	1,072
Examinations	932
Other permits, fees and licences	707
Fines	1,588
Total	95,881

Source: Ontario, *Public Accounts, 1966*.

operating public vehicles and public commercial vehicles. It is primarily on these revenue sources that we focus our attention in the remainder of the section.

PASSENGER VEHICLE LICENCES

35. The current rate structure for passenger vehicle licences in Ontario is based on the number of cylinders of the vehicle. Those with four cylinders or less are charged an annual fee of $15 if manufactured after 1934, and $8 if manufactured in or before 1934. Six-cylinder vehicles are charged $20. Vehicles with eight cylinders or more are charged $25. All electric and steam-driven vehicles pay $15 annually. Since 1921, vehicles licensed between September 1 and the end of the year have been assessed one-half the annual fee.

36. Ontario first licensed vehicles in 1903 at an annual flat-rate fee of $2. In 1915, a graduated fee based on horsepower was established, with rates ranging from $6 to $25. A combined basis of cylinders and horsepower was adopted in 1932, with rates that ranged from $7 to $40. Horsepower alone again became the basis for licensing in 1960, and in 1964 the basis was changed to cylinders alone, the current rate criterion.

37. Other provinces and states, all of which license passenger vehicles, use a variety of bases for their rate structures. Newfoundland charges a flat rate, the prairie provinces base their registration fee on the wheel base and all other provinces except Ontario use vehicle weight as the fee basis. A comparison of 1964 provincial fees is shown in Table 30:4, where the various bases have been reduced to the more general categories of "small", "medium" and "large". It is clear that all provinces gain some net revenue from vehicle registration. Passenger vehicle licence fees in Ontario are about midway between the highest and the lowest levels in Canada.

38. The fees set for passenger vehicle licences do not, on the surface, violate our principle that similar vehicles should pay similar fixed charges, but they do raise the question of the appropriate permissible variations in weight among passenger vehicles regarded as similar vehicles. In Table 30:4, between the "small" category and the "large" category there is, as the footnotes indicate, a weight difference of less than 3,000 pounds. Whether this is sufficient to justify a maximum fee that is 67 per cent higher than the minimum fee may be doubted. We leave further consideration of this question until we have discussed the ways in which road costs are occasioned and the portion of these costs that may appropriately be assigned to passenger vehicles.

TRUCK AND TRAILER LICENCES

39. Licence fees for trucks and trailers in Ontario are based on the vehicle's gross or maximum weight, a base that takes account of both the vehicle's net weight and its carrying capacity. This is a base that has been used since commercial-vehicle fees were first established in 1915. The annual rate for trucks and tractors that pull trailers ranged from $20 for those with a gross weight of not more than 2½ tons to $582 for those with a gross weight between 20 and 21 tons. For trailers, which have been charged a licence fee since 1921, the rate ranged from $5 for

TABLE 30:4

INTERPROVINCIAL COMPARISON OF 1964 REGISTRATION FEES

	Passenger Vehicles			*Buses*		*Trucks*				
	*Small**	*Medium†*	*Large‡*	*Medium§*	*Large//*	*Small¶*	*Medium***	*Large††*	*Gasoline combination‡‡*	*Diesel combination§§*
Newfoundland......	$18.00	$18.00	$18.00	$140.00	$210.00	$ 85.00	$210.00	$345.00	$405.00	$600.00
Prince Edward Island	15.00	18.50	24.50	122.00	182.00	86.00	182.00	370.00	416.00	577.00
Nova Scotia........	11.00	21.00	29.00	150.00	208.00	89.00	208.00	334.00	358.00	521.00
New Brunswick.....	15.00	26.00	35.00	130.00	192.00	86.00	192.00	370.00	416.00	577.00
Quebec............	13.60	24.10	32.50	173.50	253.00	76.00	151.00	251.00	264.50	409.00
Ontario............	15.00	20.00	25.00	101.00	137.00	88.00	179.00	391.00	271.00	430.00
Manitoba..........	9.00	16.50	24.00	39.00	79.00	120.00	240.00	420.00	480.00	765.00
Saskatchewan.......	10.00	15.00	20.00	350.00	350.00	150.00	250.00	415.00	475.00	770.00
Alberta............	10.00	15.00	20.00	35.00	35.00	85.00	160.00	320.00	460.00	580.00
British Columbia....	10.80	22.50	31.50	135.00	175.00	95.00	175.00	305.00	355.00	530.00

Source: Dominion Bureau of Statistics, *The Motor Vehicle 1964*, Part I, Tables 12, 13.

*4 cylinders or 1,770 lbs. or 94.5″ wheel base

†6 cylinders or 3,300 lbs. or 115″ wheel base

‡8 cylinders or 4,500 lbs. or 127.5″ wheel base

§gross vehicle weight 16,000 lbs.

//gross vehicle weight 20,000 lbs.

¶gross vehicle weight 12,000 lbs.

**gross vehicle weight 20,000 lbs.

††gross vehicle weight 32,000 lbs.

‡‡gross vehicle weight: tractor 20,000 lbs.; trailer 16,000 lbs.

§§gross vehicle weight: tractor 24,000 lbs.; trailer 26,000 lbs.

those of not more than 1 ton gross weight to $372 for gross weights between 20 and 21 tons. For both trucks and trailers, the rate per ton increases as the weight of the vehicle increases, an innovation that was introduced in 1919 in the licensing of trucks. Until that year, a truck with a gross weight of 2 tons or less was charged $5 and trucks above this weight paid an extra $5 per additional ton. In 1927, the principle was extended to apply to trailers.

40. Trucks and trailers used exclusively for transporting road equipment, or having apparatus attached to the chassis that is not designed for transporting people or property, are charged one-half the standard rates.

41. Commercial vehicles owned by municipalities and school boards, and all commercial vehicles except buses owned by municipal commissions, are assessed at a flat rate of $2 annually. In our view this low rate to these public bodies cannot be justified. Given the principle that prices should reflect costs, the public sector, as well as the private, should be faced with the prices necessary to pay for provincial government services received. As long as these public bodies do not pay their appropriate share of road costs, vehicle owners in the private sector will be subsidizing at least some activity in the public sector that should be supported on an entirely different tax base.[8] *We therefore recommend that:*

The licensing fees for all commercial vehicles owned by municipalities, school boards, local boards and commissions be set at the same levels as the fees for privately owned vehicles. **30:4**

42. A comparison of selected annual truck licensing charges (excluding Public Commercial Vehicle fees and Public Vehicle fees) in Ontario with those in other provinces is given in Table 30:4. In all categories except the gasoline and diesel combinations, Ontario's rate is about average. For the tractor-trailer combinations, the rate in Ontario is well below average. Most, but not all, provinces use gross vehicle weight as the basis for their rate schedules.

BUS LICENCES

43. A special rate structure applies to the licensing of buses that have seating capacity for nine or more passengers and are used exclusively for transporting people. All other vehicles used for transporting individuals are licensed either as passenger vehicles or as trucks. This separate rate structure for buses has existed since 1934. Before that time, buses were subject to the same licensing fees as trucks and the gross-weight licensing base, which has always applied to trucks, continues to be applied to buses. In 1964 annual rates ranged from $17.50 for buses with gross weights of 2½ tons or less to $396 for buses with gross weights between 20 and 21 tons. Gross weight is calculated by adding to the net weight the seating capacity times 135 pounds; for school buses, the seating capacity is multiplied by 90 pounds.

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[8]Our view, as outlined in Chapter 21, is that the Province should pay the complete road-user portion of all municipal road costs.

44. Trolley buses used exclusively within a single municipality are charged a registration fee of $2. There is, we believe, no reason for a municipality to receive a subsidy from the provincial government in this form of reduced licence fee. We have recommended[9] that all municipalities receive grants from the Province to cover the complete road-user portion of municipal road costs. Along with this, municipalities should be required, for reasons of efficiency and equity, to pay the full standard licence fee for their trolley buses. Indeed, a case could be made for charging an even higher fee, because trolley buses contribute nothing to provincial revenue through fuel taxes. *We therefore recommend that:*

The fee for licensing trolley buses be raised from the present flat $2 to at least the standard rates that apply to motor buses. **30:5**

MOTORCYCLE LICENCES

45. The registration fee for motorcycles is $10 per year, except that motorcycles registered after September 1 are assessed only half this fee. As payment for access to the public roads, this levy appears to be entirely reasonable and we therefore see no need for recommending a change.

PUBLIC COMMERCIAL VEHICLE (P.C.V.) FEES AND PUBLIC VEHICLE (P.V.) FEES

46. The Public Commercial Vehicles Act provides that a commercial vehicle cannot, in general, be rented for transporting goods unless its owner has a Public Commercial Vehicle (P.C.V.) operating licence. The Act exempts all vehicles used within one urban municipality only,[10] and all commercial vehicles used solely for transporting farm and forest products, except for those transporting milk and livestock.

47. The owner of a vehicle or vehicles used for transporting passengers for compensation must similarly have a Public Vehicle (P.V.) operating licence under The Public Vehicles Act. Exemptions apply to all trains, taxicabs, school buses, vehicles used exclusively within one municipality and some public vehicles owned by non-residents. This broad range of exemptions leaves public buses that are used to transport passengers from one municipality to another almost alone in the P.V. category.

48. In addition to P.C.V. or P.V. fees, these vehicles must pay the standard motor vehicle registration fees set for trucks and buses. This means that the P.C.V. or P.V. operating licences may be regarded as exclusively regulatory licences, and it is, of course, for regulatory purposes that they are commonly justified. In accepting or rejecting applications for P.C.V. and P.V. licences, the Ontario Highway Transport Board is able to maintain some control over the quality and cost of transportation services on the public highways. Applications that are favourably reviewed by the Board, after a public hearing, are passed on

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[9]See Chapter 21.

[10]Technically the exempted vehicle must be used within an urban zone, which may extend three miles beyond a municipal boundary.

to the Minister of Transport, along with a certificate of "public necessity and convenience", a form of wording that indicates the regulatory purpose of the licences.

49. The Public Commercial Vehicles Act was passed in 1928, and several years later, in 1931, the current nine classes of P.C.V. licences were introduced. *Class A* allows the transporting of any goods to any place in the province. *Class B* allows the transporting of goods between places not on a King's Highway. *Class C* allows the transporting of only one person's goods at a time. *Class D* allows the transporting of specific types of goods named in the licence or the goods of a specific person named in the licence. *Class E* allows the transporting of milk and cream only. *Class F* allows the transporting of livestock or other specific materials named in the licence. *Class FS* allows the transporting within a specified area of supplies for farm use named in the licence. *Class H* allows the carriage of used furniture and *Class K* allows the transporting of heavy equipment.

50. The number of vehicles operated under one licence varies. For each of the licence classes, Table 30:5 shows the number of operating licences in 1966 and the number of vehicle licences. The average holder of a Class A licence in that year owned more than sixty vehicles. At the other extreme, only a couple of vehicles, on the average, were operated under each Class E or Class F licence.

TABLE 30:5

NUMBER OF LICENCES AND VEHICLES BY P.C.V. CLASS, 1966

Class	*Operating Licences*	*Vehicle Licences*
A	253	16,239
B	22	88
C	359	4,524
D	999	5,965
E	602	1,093
F	5,551	11,845
FS	345	892
H	187	1,467
K	148	491
	8,466	42,604

Source: Ontario, Department of Transport, *Annual Report of the Minister of Transport, 1965-66.*

51. The fee for a Class E or a Class F licence is a flat $1, and for a Class FS licence a flat $10. For all other classes the licensing fee varies according to the gross weight of the vehicle (trailers and trailer-tractors are licensed separately). Licences for Classes A, C, D and K range from $10 for vehicles weighing less than 2 tons to $157.50 for vehicles between 20 and 21 tons; for Classes B and H, licences cost from $10 for vehicles weighing less than 2 tons to $79 for vehicles between 20 and 21 tons.

52. Since The Public Vehicles Act was passed in 1923, buses have paid P.V. fees on a passenger-mile, or more correctly a seat-mile, basis. The number of

passenger-miles for each vehicle is reckoned by multiplying the miles travelled by the seating capacity. The current fee is 3¢ for each 100 passenger-miles travelled on provincial highways and 2¢ for each 100 passenger-miles driven on county highways. In 1964, 3,252 buses were operated on 282 P.V. licences.

53. Although the revenue received from P.C.V. and P.V. permits is not a significant portion of the total revenue collected by the Department of Transport, it does substantially exceed the costs of administering these permits.[11] As a result, the contribution made by owners of public commercial vehicles and public vehicles exceeds that made by owners of similar private vehicles. There is clearly no reason to suppose that for similar vehicles moving similar distances, the road costs incurred as a result of public motor vehicle traffic are any different from the costs incurred as a result of private motor vehicle movement. If the average public motor vehicle travels farther per year than the average private vehicle—and we have seen some evidence that this is so—fuel taxes will more appropriately apportion responsibility for costs incurred in this travel than would differential fixed fees for the two groups.[12] The revenue from P.C.V. and P.V. licences is a charge against public motor vehicles that ultimately reduces their use and tends to shift vehicle traffic into the private category. The use of private commercial trucks or buses and private passenger vehicles is thereby enhanced. We accept the argument that public motor vehicles should be subject to regulation of the present kind and that they should bear the costs of administering these regulations, but we believe that to the extent that P.C.V. and P.V. fees produce net revenue—i.e., revenue in excess of administrative costs—an element of unwarranted discrimination is introduced into the process of allocating road costs between types of vehicles. *We therefore recommend that:*

The fees charged for operating licences under The Public Commercial Vehicles Act and The Public Vehicles Act be set at a level such that the revenue derived will approximate the costs incurred in administering these two Acts. **30:6**

54. Our intention in formulating this recommendation is not only to call for a reduction in the gross amount of P.C.V. and P.V. fees but also to relate any differences in fees for different classes of these vehicles solely to differences in administrative costs. We do not, however, propose any specific change in the structure of the rates, because the whole matter of most appropriate P.C.V. licensing arrangements is currently under study by the Ontario Highway Transport Board. We have therefore limited our concern to the broader problem of the appropriate relationship between P.C.V. and P.V. fees and motor vehicle charges in general.

[11]The Highway Transport Board is self-supporting through service charges that must accompany initial applications and the biannual reports of certain categories of P.C.V. certificate holders. The annual expenses of the Vehicle Inspection Branch of the Department of Transport, which administers the P.C.V. and P.V. licences, amounted to less than 25 per cent of the revenue from these licences in 1964.

[12]This and related points are elaborated below in this chapter.

DRIVER AND CHAUFFEUR LICENCES AND LEARNER PERMITS

55. Licences for drivers and chauffeurs are currently issued for a three-year period at a charge of $2 a year. (Three-year chauffeurs' licences have existed for some time but the change-over from annual to three-year drivers' licences began only in 1964.) Learners' permits, which are issued for ninety days, cost $2. One-half of the fees for drivers' and chauffeurs' licences is paid into the Motor Vehicle Accident Claims Fund; the other half is included as revenue from fees, permits and licences.

56. These licences exist for regulatory purposes only and the charges for them should not be expected to contribute to net revenue. Administrative costs do appear to fall somewhat short of revenue from the licences, but the licence fee is sufficiently small that we do not recommend a change. Any excess revenue may be considered to cover the deficit that is incurred in the testing of applicants for licences. The average cost of a driving examination is $4.75,[13] but charges for this testing range from $3 for an original test to $1 for the test required of older persons.

OTHER RELATED CHARGES

57. There are, in addition to the charges already covered, a miscellany of fees related to selling, operating or servicing motor vehicles. Fees are charged for transferring vehicle ownerships, for licensing vehicles in transit, for licensing driving instructors, for duplicate permits, for licence searches and so on. Dealers and garages that store, sell, service or buy and wreck motor vehicles are charged a licensing fee. None of these fees is intended to contribute to the user portion of road costs and for most of these licensing programs there is no great discrepancy between the administrative costs and the revenue received. We nevertheless believe that garage licences and transfer fees are slightly higher than can be justified.

58. In order to provide a measure of control over the disposition of motor vehicles, garages that store and sell vehicles are required to purchase a Class A licence, those that service and repair vehicles must purchase a Class B licence (unless they have a Class A licence) and those that buy and wreck vehicles must purchase a Class C licence. In 1964 the government received about $366,000 from the sale of these licences and incurred an estimated $20,000[14] in administration costs. The difference between these costs and revenues is not justifiable. *We therefore recommend that:*

> ***The fees for the various categories of garage licences be reduced to a level such that the revenue derived will approximate the cost of licensing.*** **30:7**

59. Purchasers of both new and used cars must pay a fee of $2 for the transfer of the vehicle permit. In the 1966 fiscal year these fees contributed slightly over $1 million to general revenue, while costing only a fraction of that amount to administer. *We therefore recommend that:*

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[13]Information received from the Ontario Department of Transport.

[14]This is a rough estimate, provided by the Department of Transport, of licence fees received during the 1964-65 fiscal year.

The transfer fee charged to purchasers of motor vehicles be reduced to a level such that the revenue derived will approximate the cost of registering the transfers. **30:8**

INTERPROVINCIAL LICENSING RECIPROCITY

60. To complete the licensing picture, the reciprocity agreements between Ontario and a number of the other provinces should be mentioned, although we have no changes to recommend. All provinces (and states) allow passenger vehicles licensed elsewhere to use their roads without paying a fee. This full reciprocity is frequently extended by agreement to cover all vehicles having a gross weight of less than 6,000 pounds and those vehicles of any weight that carry used household goods or objects of art or farm products. Ontario permits these categories of foreign vehicles to use provincial roads without charge, whether a reciprocal agreement exists or not. Vehicles exceeding 6,000 pounds gross weight and not carrying the specified items pay the full registration fee, unless a reciprocal agreement covers their licensing. Between Ontario and each of the provinces of New Brunswick, Manitoba, Saskatchewan, Alberta and British Columbia, a reciprocal agreement permits non-exempt private and public vehicles of the reciprocating province to pay a reduced annual registration fee of $10 a gross ton.

61. No very conclusive case for or against reciprocal licensing agreements can be made, at least in terms of the appropriate assignment of provincial road costs. If the fixed licence fee is a levy to cover road costs that are independent of road use, there clearly is no reason to charge a foreign vehicle less than a domestic vehicle. If, on the other hand, the licence fee is an adjustment to the fuel tax and intended to relate to distance travelled, foreign vehicles might well pay less than domestic vehicles, on the argument that the former use the road system less. Whether or not full licence fees are paid by foreign vehicles, a substantial portion of their contribution towards provincial road costs will be met through fuel tax payments. In Ontario, commercial vehicles are allowed to bring no more than forty gallons of tax-free fuel into the province.

INCIDENCE OF MOTOR VEHICLE CHARGES

62. To ask who bears the burden of motor vehicle charges is much the same as to ask who would benefit if all such charges were eliminated and the road-user portion of road costs borne by kindly Providence. The answer to this question forms part of the background information needed for a complete understanding of the way in which the burden of the provincial tax system is distributed within the community, but the importance of the answer is almost overshadowed by the intractability of the question. Not enough is known about the supply conditions in the motive-fuel and motor vehicle markets, or about the demand for fuel, or about the trucking industry, to do any more than make reasonable assumptions about the incidence of motor vehicle charges.

63. Fuel taxes, which we deal with first, are members of the commodity tax family. As such, much of the analysis in Chapter 29 relating to the incidence of

the sales tax is relevant to our present discussion. Rather than repeat the analysis here, we refer our readers to that chapter.

64. Motor vehicle owners who pay fuel taxes may be divided into two broad categories according to the ease with which they may or may not be able to shift forward the fuel tax. In the first category are the owners of private passenger cars and in the second are the owners of commercial vehicles, public or private. The taxes paid by the second group are part of the cost of producing a good or service and therefore are likely to be shifted forward to the consumer of the good or service. Owners of private non-commercial vehicles must either bear the burden of the fuel tax themselves or shift it, in total or in part, back to fuel suppliers.

65. In analysing the incidence of the tax on fuel used in private non-commercial vehicles, it is important to decide what would happen to the price of fuel if the tax were completely removed. It appears likely that under present market circumstances, the price of fuel would drop by the full amount of the fuel tax. We advance two reasons for this conclusion. First, it is believed that competition in the fuel supply industry would eliminate the higher profit margins that would result if the price of fuel did not drop by approximately this amount. Second, the consumption of fuel, most people argue, would remain about the same whether the tax was imposed or not. The relevance of this second argument derives from the assumptions that if fuel suppliers are now getting what they regard as an optimum price for their fuel (not including the tax that goes to the government), and if consumption were to remain at about the same volume after the tax was removed, there would be no reason for suppliers to change the level of what they believe to be the best price (excluding tax) to charge. If this view—that the price of fuel would drop by the full amount of the tax if the tax were removed—is correct, then the tax is not shifted back to fuel suppliers but is borne by the owners of private non-commercial vehicles.

66. Taxes paid on fuel consumed in commercial vehicles may also be borne by the owner of the vehicle or shifted back to fuel suppliers. Here there exists the third possibility that they may be shifted forward, in whole or in part, to the owner's customers. In such an event, the argument of the preceding paragraph may be used to show that it is equally unlikely that fuel taxes are shifted back. Whether they are borne by the owner or by the owner's customers is a question that is answered with considerably less agreement.

67. The key question to be considered here is what would happen to the prices of goods or services if the tax on fuel for commercial vehicles used in the production or distribution of these items were to be eliminated. If these prices were to fall by the whole reduction in production costs, the tax has been borne by the customers, while if the prices were to stay the same, the tax has been borne by the owners of the commercial vehicles. It might, of course, be borne partly by each group.

68. After assessing the available evidence, which is scanty, we accept the view that much of the tax on fuel used in commercial vehicles is shifted forward to

customers. The argument is that if the tax were removed and product or service prices remained unchanged, then above-normal profits would attract new entrants to the product or service markets. Prices would then fall as output rose and the old prices could not be maintained. This reasoning is most applicable to the trucking industry, where entry is relatively easy and outlays for fuel constitute a significant part of total operating costs. The longer the period allowed for adjustment to a change in the fuel tax rate, the more relevant this argument becomes. In the period immediately after a fuel tax change, the difference between the old and the new tax might well be borne entirely by the commercial-vehicle owner.

69. Having concluded that fuel taxes are borne by private non-commercial vehicle owners, and by the consumers of goods and services produced and distributed with the aid of commercial vehicles, we now look briefly at the distribution of the fuel tax burden among different income groups.[15] Expenditures on car operations as a proportion of family income rise as the levels of annual incomes increase to about $6,000, and then they decline. On the assumption that spending on fuel is proportional to car-operation expenditures, the proportion of family income that goes to taxes on fuel will also follow this pattern, rising to the $6,000 category and then falling. If we further assume that the fuel taxes shifted forward to consumers are distributed in proportion to the total consumption of all commodities by the various income groups, and that the ratio of consumption expenditure to income does not vary greatly among these groups, we can then conclude that for all income groups about the same share of their income goes to these taxes. Our conclusion is therefore that the total burden of all fuel taxes is an increasing proportion of family income up to about the $6,000-a-year category, beyond which it is a declining proportion of income.

70. Fixed annual motor vehicle charges, such as registration fees and P.C.V. or P.V. fees, may be borne by the owner of the vehicle, by the manufacturer or seller of the vehicle, or, in the case of commercial vehicles, by the customer of the firm using the vehicle. There are no very good reasons for thinking that if the fixed fees were eliminated, the price of motor vehicles would rise. We therefore conclude that these charges do not fall on the vehicle supplier. This being so, fixed charges on private non-commercial vehicles must be borne by the vehicle owner, but the charges on commercial vehicles may be shifted forward in whole or in part.

71. Following our earlier arguments regarding the incidence of fuel taxes, we feel that the longer the period allowed for adjustment to the imposition of, or to a change in, the fixed fees, the greater the likelihood that the tax burden falls on the final consumer. If this were not so, long-run profits in industries using commercial vehicles would depend in part on the level of the licence fees, and this most observers believe is unlikely. Long-run profits are generally thought to be related to the profit levels in other industries and not to changing costs in one given industry. To illustrate, above-normal profits in the trucking industry brought

[15]The study on *The Incidence of Government Revenues and Expenditures*, by J. A. Johnson, prepared for this Committee, should be referred to for more detail on this subject.

about by reduced licence fees would attract new firms to the industry, or encourage old firms to expand, until the profit level was returned to normal.

72. We accordingly conclude that the incidence of fixed charges is roughly the same as the incidence of fuel taxes and that the burden of these fees will be distributed among income classes in the same way as the fuel tax burden.

ALTERNATIVE REVENUE SOURCES

73. In this section we examine briefly the arguments for and against two commonly used alternative ways of meeting road costs: tolls on roads and other facilities, and municipal licence fees for motor vehicles. Weight-distance taxes, which are also common in some areas outside Ontario, are considered in the final section of this chapter, where their value as a distance levy is judged by comparing them with fuel taxes.

TOLL FACILITIES

74. Although nineteenth-century roads in Canada relied heavily on tolls for their financing, the post-1945 toll-road boom in the United States did not spread to this country. South of the border, the rapid post-war increase in highway use, the limitation (in some states) that roads be financed entirely from user revenues, the restrictions placed on borrowing for road construction, and the desire of small states to have foreign vehicles pay a larger share of road costs have all combined to create pressures for toll-road construction—pressures that were not encountered in Canada. At present, all toll roads in this country are in Quebec, where the Laurentian Auto Route, the first of several current toll-road projects, was opened in 1959. In other parts of Canada, the only toll facilities are bridges, tunnels and ferries. Aside from the international bridges and tunnels, the sole toll facilities in Ontario are the Burlington and the Garden City Skyways. During the fiscal year 1966, these two bridges together yielded toll revenues approximating $1.7 million.

75. The apparent benefit of a toll road to the driver is that he is provided with an efficient limited-access route for long-distance travel. But because such roads are available without toll in many areas, the mere existence of a toll road is not an indication of its advantage. For toll roads to be judged better than free roads, one or both of two conditions must be satisfied: either the toll arrangement must facilitate the building of roads that are economically desirable to build and that otherwise would not be built, or the toll must be more efficient and equitable than conventional financing as a means of collecting the user portion of the road cost.

76. If an area is constrained to use only motor vehicle revenues to finance the building of roads and if these revenues cannot easily be altered, then the first of the above two conditions may hold and charging tolls may be the best way to finance roads. This appears to be the situation in a number of American states, but there is no such constraint on Ontario road-building. The second condition in the preceding paragraph may be met in the smaller "bridge states", where it is difficult to capture even a fuel tax from foreign vehicles, but Ontario is sufficiently large to minimize this problem.

77. The use of tolls to finance road costs has a subtle disadvantage. Within an economic planning unit such as Ontario, the decision relating to which road to build next should be made independently of the method of financing the roads. The Province should spend resources to build roads in those directions that offer the greatest benefit for each dollar spent. If, however, tolls are used on some roads, such as multi-lane highways, but not on others, the Province will be tempted to bias its road-building towards the self-liquidating toll facilities and away from what are possibly more urgently needed urban roads or northern highways. In other words, when toll facilities are used, the method of financing may distort priorities relating to road-building.

78. If it is assumed that road-building decisions are correctly made, with or without toll financing, can it then be argued that tolls in general are more efficient and equitable than conventional financing, aside from the "bridge-state" position? If road-user payments are to be made according to benefits received, tolls would appear at first glance to be ideally suited for the purpose. But we stated at the beginning of this chapter that benefits received are roughly equivalent to costs occasioned, and it is not nearly so clear that a mileage toll bears a direct proportional relationship to the costs incurred. Since a substantial part of road expenditures comprises fixed costs and repair expenditure unrelated to use, it might be thought best to set a fixed fee for using the road for any distance and for any number of times. If it is urged that benefits received should in this case comprehend more than costs occasioned, the difficulty is immediately encountered that the beneficiaries of multi-lane through highways include, to a significant extent, the users of the local roads that would be congested if the through toll highway did not exist. Our conclusion from these arguments is not that conventional financing by means of fuel taxes and licensing fees is superior to toll facilities, but that placing tolls on roads has not been proved to be a better way of financing the facilities. Moreover, there are other disadvantages that can be shown. To those already mentioned may be added the inconvenience to the motorist and the extra cost involved in collecting the toll.

79. The same arguments can be made against the use of tolls on facilities other than roads. Ontario's two "skyways" are part of a larger road network and the decision to build them should have been taken—and presumably was taken—within the context of the over-all Ontario road system, and not simply on the ground that they would be toll financed. Once built, on whatever ground, we see no valid argument that a toll should be charged for their use. *We therefore recommend that:*

> ***Toll charges for the use of the Burlington and the Garden City Skyways be eliminated.*** **30:9**

MUNICIPAL LICENSING OF MOTOR VEHICLES

80. In addition to the standard provincial or state charge, there is in some areas of Canada and the United States a municipal motor vehicle registration fee. In Canada this has been confined to certain municipalities in New Brunswick and

Newfoundland that levy taxes on some or all motor vehicles, and to municipalities in British Columbia that tax only commercial vehicles.

81. Municipal levies can take many forms, but their only legitimate purpose is that of collecting from motor vehicle owners the contribution that they should make towards municipal road costs and that otherwise would not be collected. We believe that motor vehicle charges are not appropriate devices for explicitly redistributing income or adding to general revenue an amount unrelated to road costs. Given our earlier recommendation in Chapter 21 that the Province should meet the total road-user portion of municipal road costs, we think that municipal motor vehicle registration fees should not be introduced in Ontario.

MOTOR VEHICLE REVENUES IN RELATION TO ROAD COSTS

82. Because the beneficiaries of road services can be more easily identified and charged for these services than can the beneficiaries of a great many other government outlays, and because motor vehicle charges are not a good instrument for redistributing income, we believe that the appropriateness of the revenue raised by these charges should be judged according to the portion of road costs that they cover. In this section, our main goal is to determine the part of total road costs that might justifiably be borne by road users and then to compare this computed proportion with the share of road costs actually borne by road users in Ontario. To accomplish this, we begin by discussing the over-all level of road costs.

ROAD COSTS

83. Establishing the current or anticipated level of road costs is not quite so straightforward a process as it might at first appear. Here we note that there are two types of costs, the first and more important consisting of the direct capital and maintenance costs associated with providing a road system. The second type, more nebulous, is the cost to society of road noise, road congestion, air pollution by vehicles, and the general cutting up of the countryside and city by roads. The first type of cost is more readily measured and we concentrate most of our attention on it, but the second type cannot be overlooked.

84. Turning to the direct capital and maintenance costs, we encounter the problem of how these costs may be estimated. Ideally, the annual costs in this case should be measured by capitalizing the value of all capital facilities and then calculating an annual interest charge on this capital value. To this should be added annual maintenance and depreciation costs and any other annual service costs, such as those incurred in highway duty by the Ontario Provincial Police and in administrative duties by the Department of Transport. Unfortunately, it is not possible to proceed in this ideal manner. The practical problems involved in the attempt to capitalize the value of roads have proved insurmountable to virtually all investigators in this country and in the United States. Instead, it is customary to forecast the average annual capital expenditures over some long future period, and to add this to the annual maintenance and service costs; the result is an estimate

of total annual road costs. Some writers have argued that in a region where roads are reasonably well developed and the road system is growing at a roughly constant annual rate, this method of estimating road costs may not differ greatly from the ideal road-capitalization method. This argument is far from conclusive.

85. Proceeding then in the only practical way, we have derived our estimate of the annual road costs over a twenty-year period from a study made by the Ontario Department of Highways.[16] Using 1957 prices, the study indicated that over the period 1958 to 1977 the average annual expenditure in Ontario on road construction and maintenance was expected to be $358 million.

86. For use in comparison with current motor vehicle revenues, we have made two adjustments to this estimate of road costs. The first adjustment is an increase in municipal expenditures included in the $358 million estimated by the Department of Highways. According to the Department, expenditures by municipalities slightly exceeded $100 million in 1958 and increased to around $207 million in 1965; we estimate the amount for 1966 at $236 million.[17] However, these figures refer only to road construction that is eligible for provincial subsidization. The Dominion Bureau of Statistics, in its annual publication *Road and Street Mileage and Expenditure*, reports gross municipal expenditures that are about 30 per cent larger than those calculated by the Department of Highways. This total may be somewhat high because the D.B.S. estimate includes the cost of sidewalks, which we do not include as a road cost, although it excludes expenditures for traffic direction, which are genuine road costs.[18] We believe that for our purposes in this chapter, the best estimate of gross municipal road costs is a figure roughly 25 per cent higher than the estimate included by the Department of Highways in its expected average annual total road costs of $358 million.

87. The second adjustment we make takes account of the rising unit costs of road construction and land acquisition since 1957. Several studies in related fields have used an annual price rise of 2.5 per cent; this we also use.[19]

88. By adjusting the $358 million figure for both price increases and the understating of municipal road expenditures, we obtain a new estimate of current annual road costs of $520 million. To this amount must be added administrative expenditures by the Department of Transport and an appropriate portion of the cost of maintaining the Provincial Police. For the latter item we follow the lead of the Research Branch of the Ontario Department of Transport, which in its

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[16]*Ontario's Roads and Streets: An Engineering Study*. This was produced by the Department of Highways in 1958 and covers the period 1958 to 1977. More recent work by the Department has shown that their estimates continue to be satisfactory.

[17]Including amounts financed by provincial subsidies.

[18]Another Dominion Bureau of Statistics publication, *Financial Statistics of Municipal Governments*, includes a capital-expenditure item that is about half again the amount given for municipal road expenditures by the Department of Highways. This second D.B.S. figure is commonly used as an alternative estimate of municipal road expenditures (see Chapters 5 and 6 of this Report), although it includes some subway costs and public-building expenditure.

[19]Our conclusions are not sensitive to downward revisions in this price change, and there is some evidence that, if anything, 2.5 per cent annually may underestimate the rate at which unit road costs have been rising.

studies includes in total road expenditures three-quarters of the annual cost of the Provincial Police. For 1967 this brings our total estimated annual road costs to $550 million. It should be remembered that this is an average annual figure based on a twenty-year program of road construction, and that actual expenditures in 1967 may be above or below it.[20]

89. With this estimate in hand, we must comment on the other costs of the road system—the social costs. There is really no way of measuring in dollars the seriousness of air pollution, road congestion and the other side effects of the use of roads. Our immediate concern is to determine what part of these social costs should be met through motor vehicle revenues. Here it is relevant to observe that most but not all of the consequences of road congestion fall on the motorist alone and these clearly do not have to be assigned a money cost. They fall directly on the people causing them. By contrast, the effects of air pollution and unsightliness extend beyond the motorist to the general public. It is important for the attainment of an efficient allocation of society's resources that these and other social costs relating to road use should be recognized. They are an important component in any realistic assessment of total road costs, but in fact they are impossible to estimate. It is fortunate that in leaving them out of our cost estimate we may not be led to as much error as at first appears. Conversely, the general public also benefits from a road system in a nebulous way that is incapable of measurement. For example, roads are used by national defence units and by other government departments, they provide a method of emergency travel even to those who customarily do not use them, and so on. In the paragraphs that immediately follow, we exclude from the cost responsibility of motorists only those road costs that are incurred in providing access to properties. Strictly speaking, these other, more broadly distributed benefits should help reduce the share of road costs borne by motor vehicle revenues. Excluding an unmeasurable cost at least provides a plausible logic for excluding an unmeasurable benefit. Any remaining error will necessarily be less than if the cost or the benefit were taken alone.

FINANCING ROAD COSTS

90. At the heart of the problem that we are discussing is the question of how road costs should be financed. Any answer to this question is necessarily arbitrary, because there are no prior rules to judge how things *ought* to be, but in the literature on this subject standard methods of tackling the question have been evolved—methods that have the support of a working consensus at least.

91. The main task is to separate the responsibility for road costs into a user share and a non-user share. For this, the usual point of departure is to argue that, aside from motorists, property owners derive the greatest benefits from roads because roads provide access to property. Other less easily defined benefits also accrue to the general public, but these, as we have already mentioned, are set off against costs that cannot readily be assigned a dollar value. The general principle established from this reasoning is that motorists or road users should be required to

[20] If the appropriate items from the provincial spending estimates for 1967 are added to the estimated municipal expenditures, the actual road expenditure is expected to be about $570 million.

pay only for that portion of the road system that is not designed to provide access to property. Many roads, of course, serve the dual purpose of travel and access, and for this reason some formula for apportioning costs between users and non-users must be worked out.

92. A number of formulas have been derived and used for this purpose. The most popular of these is called the "earnings-credit method" of cost allocation. This has been the principal formula used in most of the recent North American inquiries, and it was heavily relied upon by the Research Branch of the Department of Transport in its study of the problem. We base our conclusions on research done by that Department.

93. The earnings-credit method is in a sense a compromise between several alternative methods of cost allocation, methods that in themselves are either too difficult to use because of lack of data or are not sophisticated enough to produce a reliable estimate. For each of the various types of rural and urban highways, the method depends on the availability of data relating to estimated annual expenditures per mile of road and the vehicle-miles travelled by all vehicles. The user portion of road costs is calculated in two ways, the first of which is to assign to users the total cost responsibility for King's Highways, for the urban extensions of King's Highways and for urban expressways. The cost of King's Highways is converted to a cost per vehicle-mile and this figure is then applied to the estimated vehicle-mile travel as the user portion of costs on all other rural roads (secondary highways, county roads and township roads). Similarly, the average cost per vehicle-mile on urban extensions of King's Highways and urban expressways taken together is applied to the estimated vehicle-mile travel to arrive at the user portion of costs on all other urban roads (arterial roads and local streets). By appropriately weighting and adding these items, the first estimate of total user responsibility is found. A second estimate is then made by assigning total responsibility to non-users for the costs of township roads and local streets. Each of these is then converted into a cost per road-mile, and that figure is applied to all other roads as the non-user share. The cost per mile for township roads is applied to county roads, secondary highways and King's Highways, and the cost per mile of local streets is applied to arterial streets, urban expressways and urban extensions of King's Highways. When these are appropriately weighted and combined, the non-user share of all road costs is found, from which, by subtraction from total estimated costs, a second estimate of the user responsibility can be made. Finally, these two estimates of the user share are averaged to obtain the over-all cost responsibility of road users.

94. Using the method we have just described, the Department of Transport has estimated the user responsibility for road costs at 68 per cent. This is the weighted average for all classes of rural and urban roads.

95. It is clear that it is impossible to set a specific percentage for the share of road costs that should be met by motor vehicle revenues. To set a range of percentages within which an acceptable share would fall is a much more realistic approach. On the basis of our own analysis, we feel that current motor vehicle

revenues in Ontario should range somewhere between 65 and 75 per cent of average annual road expenditures. If it is found that future expenditures are directed increasingly toward user-intensive roads, such as expressways, this range should be raised.

CONCLUSIONS

96. We have estimated that annual road expenditures in Ontario, averaged over a reasonable length of time, are about $550 million in current dollars. Based on the figures in the 1966-67 provincial budget, corrected for the elimination of tolls and the reduction in fees, which we earlier recommended, motor vehicle revenues will be about $375 million. This is 68 per cent of estimated road expenditures, a value that falls at the lower end of our acceptable range. It follows, therefore, that some increase in user charges could properly be countenanced. Estimated annual road expenditures could range from a low of $501 million to a high of $578 million and still permit our projected motor vehicle revenues to fall within the 65 to 75 per cent proportion of costs.

THE DISTRIBUTION OF MOTOR VEHICLE CHARGES AMONG ROAD USERS

97. Although we have concluded that the over-all level of motor vehicle revenues is acceptable, this does not imply that the distribution of charges among categories of motor vehicles is also acceptable. The purpose of this last section is to discuss this distribution. Here again we have relied heavily on research undertaken by the Ontario Department of Transport.

THE ALLOCATION OF CHARGES

98. Throughout this chapter we have held to the principle that charges imposed upon any group of motor vehicles should be related to the road costs occasioned by that group. On this principle, several methods of allocating charges have been devised, of which the most highly regarded and the most generally used is the "incremental cost" method.

99. To use this method, a considerable amount of information is needed with respect both to motor vehicle categories and to road costs. The Department of Transport has grouped vehicles into eighteen major divisions (passenger cars, private truck, P.C.V. truck, urban bus, etc.), each of which has been further subdivided into gross-weight categories and axle classes. For each of these sub-groups, estimates of annual vehicle-miles travelled are made. Roads were classified into thirteen categories and the costs incurred for each category of road were divided into four segments: (1) costs related to the number of vehicles using the road; (2) costs related to the number of vehicle-miles travelled on the road; (3) costs related to the axle weight of vehicles using the road; and (4) costs related to the gross weight of vehicles using the road. Large amounts of engineering data were used in making this division.

100. Road-cost items in the first category encompass expenditures such as those of the Department of Transport, and they are allocated among the vehicle classes

according to the number of vehicles in each. Costs in the second category are judged to be related to annual road mileage and are distributed among vehicle classes in proportion to the estimated total miles travelled by the vehicles in each class; right-of-way and snow-removal expenditures are in this category. The third and fourth categories comprise expenditures incurred to provide roads for heavy vehicles over and above the expenditures necessary to provide roads for passenger vehicles and light trucks. The costs of building stronger bridges, thicker roadbeds and pavements necessary for heavy trucks are included here. These costs are distributed among the appropriate vehicle classes according to the axle weight or gross weight of each class.

101. When this distribution has been completed, total road expenditures are assigned to the vehicles in each class in a way that allocates any extra costs to the relevant class of vehicles for which these costs have been incurred, while spreading the basic road costs among all vehicles. The better the engineering data, the more accurate will be this distribution.

102. The final step is to compare a distribution of the user share of road costs made on the above basis with the best estimates available of the actual amount borne by each class of vehicle. From this kind of comparison we draw the conclusion that the present revenue structure in Ontario tends to charge passenger vehicle and light truck owners less than the road costs they occasion, while the owners of heavy trucks and buses are more than meeting their cost responsibility.

103. We nevertheless believe that there is some justification for this kind of discrepancy. The incremental cost method does not take account of road congestion costs—costs that fall on the motorist in the form of frayed nerves and lost time. Heavy vehicles with slower acceleration generally add more to congestion costs than do light vehicles. An appropriate way to compensate owners of light vehicles is for owners of heavy vehicles to assume a disproportionate share of direct road costs and thereby to lighten the charges on the former. Because this kind of compensation is what appears to be occurring under present arrangements, we are not inclined to make any recommendation for a basic change in the revenue structure, although it must be admitted that we simply have no way of knowing whether or not congestion costs are being adequately met.

FIXED AND VARIABLE CHARGES

104. We have not yet commented on the allocation of charges among motor vehicles within one category, although we have stated our satisfaction with the allocation among categories. The incremental-cost method makes use of the total number of vehicles within one category and the total vehicle-miles travelled by these vehicles. It takes no account of the fact that different vehicles even in one category may have quite different annual mileages.

105. Under the present system of motor vehicle charges, the more a vehicle uses the roads the more it pays in fuel taxes. For almost all categories of vehicles, the average revenue contributed in fuel taxes greatly exceeds revenue from permits and licences.

106. The results of the incremental-cost analysis justify this primary reliance on a distance tax, such as the fuel tax, as a source of motor vehicle revenue. Research by the Department of Transport indicates that although most road costs are related not to weight or to the number of vehicles but to vehicle-miles travelled, it is nevertheless appropriate to use fixed fees based on weight as one source of road-user revenues, provided that these fees are not the main source of such revenues. Thus, there is reason to conclude that the distribution of motor vehicle charges, within categories of vehicles as well as among categories, is not seriously wrong.

107. The research we have studied also leads us to conclude that the licence fee for private passenger cars should be set at one flat rate. There is no evidence to suggest that the weight difference between small and large passenger cars leads to any different cost responsibility for the two groups. This flat rate should be set at a level such that the total revenue from this source will not be reduced. To accomplish this, a fee of between $20 and $25 per vehicle must be charged. We think that the higher of these fees is the more appropriate because the current level of all motor vehicle revenue in relation to road costs is found near the bottom of the acceptable range. Corresponding to this change, the licence fee for trucks with a gross weight of less than 2½ tons should be raised from $20 to $25, and for those with a gross weight between 2½ and 3 tons the fee should be raised from $25 to $30. *We therefore recommend that:*

> ***The licence fee for passenger vehicles, dual-purpose vehicles and trucks weighing less than 2½ tons gross weight be set at a flat rate of $25, and the licence fee for trucks from 2½ to 3 tons gross weight be raised to $30.*** **30:10**

108. Finally, we feel that some comment is in order concerning the use of a fuel tax as the sole levy based on distance travelled. Alternative weight-distance taxes are frequently suggested because, it is argued, fuel taxes do not adequately charge for the combination of vehicle weight and miles travelled. The argument is that although the heavier the vehicle the more fuel it uses per mile, the use of fuel does not increase at as rapid a rate as the weight of the vehicle. It therefore follows that the tax payment per ton-mile is greater for passenger cars, for example, than for heavy trucks. Based on this argument, several types of weight-distance taxes have been proposed, some that would charge all vehicles a flat rate per ton-mile travelled and others that would charge on a ton-mile basis, but at different unit rates for different categories of vehicles.

109. Contrary to all of these suggestions, the results of an allocation on the incremental-cost method clearly show that there is no particular reason to assign charges on a ton-mile basis. In fact, as we have mentioned, most road costs are related not to vehicle weights but simply to distance travelled. We have found that the present allocation of charges among motor vehicles is at worst not grossly unsatisfactory, and there is no indication that an additional weight-distance tax, which would carry with it substantial administrative costs, is required by considerations of equity.

Chapter 31

Other Provincial Taxes

INTRODUCTION

1. This chapter deals with a number of miscellaneous taxes that are not mentioned in previous chapters and do not fall within the general areas of natural resources or alcoholic beverages. Although they differ markedly in structure, generality and rate, they are all imposed in relation to some specific transaction. While there is thus some community among these levies, they are sufficiently different, being imposed on the sale, purchase or transfer of such disparate things as tobacco, entertainment, insurance, land, securities and pari-mutuel winnings, that with the exception of the three taxes on insurance premiums we have found it convenient to discuss each separately.

THE TOBACCO TAX

DESCRIPTION

2. The tobacco tax is the most recent of Ontario's taxes, having become effective with the exemption of tobacco products from the retail sales tax, on January 1, 1966. Originally levied at a rate that had similar impact to that of the 3 per cent sales tax, it was doubled when the latter tax was increased to 5 per cent.

The particular form of tax was adopted to facilitate the administration and collection of the tax on tobacco. At its present rate the tobacco tax is expected to yield $18.5 million in the fiscal year ending March 31, 1968.

3. The tax is levied on the consumers of all kinds of tobacco products, including cigarettes, manufactured tobacco, cigars and snuff. The consumption in Ontario of tobacco that was purchased outside the province is also taxable. Wholesale dealers, acting as agents of the Province, are responsible for collecting the tax and remitting it to the Treasurer. Dealers who have not been appointed collectors for this purpose must collect the tax and turn it over to a collector. The present rates impose a tax of 0.1¢ per cigarette and 0.2¢ for every 5¢ or part of 5¢ of the retail price of a cigar. For tobacco other than cigars and cigarettes the rate is 1¢ per ounce or part of an ounce where the price is less than 50¢ per package, and 2¢ per ounce or part of one ounce where the package is priced at 50¢ or more unless two ounces or more is sold in a package priced at an amount that represents less than 25¢ per ounce, and then the tax is 1¢ per ounce or part of an ounce.

4. By far the largest proportion of tax is collected from consumers of cigarettes, accounting for over 88 per cent of the yield. It is this part that is also the easiest to collect, being a simple amount per cigarette. The amounts collected on account of cigars and other tobacco present a greater administrative problem, since final selling prices are not always known by the wholesaler. Although collection would probably be simplified somewhat if tax were calculated for these products on a simple quantity per unit, that is per cigar or ounce of tobacco, it has been argued that this would destroy the similarity of this tax to sales tax, and impose an undue burden on cheaper domestic products that compete with more expensive imports. Although the tax is thus not as simple as it might conceivably be, it is nevertheless relatively easy to administer. Remittance is made by just under two hundred licensed collectors on the basis of the purchases made each month from manufacturers. The result is that it is much easier to provide adequate audit coverage than when literally thousands of vendors collected retail sales tax on tobacco products. Administration of The Tobacco Tax Act has been entrusted to a section of the Gasoline Tax Branch of Treasury where the procedures of collecting and auditing at the wholesale stage of distribution are well understood.

COMPARISON WITH OTHER PROVINCES AND STATES

5. Experience has shown that great disparities in the price of cigarettes among neighbouring jurisdictions lead to smuggling on a rather grand scale. Thus it is important to look at the rates of tax on tobacco products in the other provinces, particularly in Quebec and Manitoba, as well as in neighbouring states.

6. In this connection it is important to recall the effects of the short-lived federal tax increases of 1951-53 that were mainly responsible for cigarette prices rising from 36¢ to 42¢, a leap of 16⅔ per cent. Before the tax was reduced, it was estimated that nearly 10 per cent of the domestic Canadian market was supplied by cigarettes imported illegally from the United States.[1] Since the removal of

[1]Flue-cured Tobacco Marketing Association of Ontario, Brief to the Minister of Finance, Feb. 22, 1955.

the higher tax, smuggling has diminished markedly. Cigarette prices have risen gradually and have generally been matched by at least equal increases in bordering states. This experience indicates that, while some disparity in prices for cigarettes can be tolerated, large, dramatic changes can have most unfortunate effects. The actual point at which the disparity leads to large-scale smuggling is, however, unknown.

7. Table 31:1 summarizes the taxes on tobacco levied by the various Canadian provinces. Only Alberta refrains from imposing some levy on the noxious weed.

TABLE 31:1

PROVINCIAL TAXES ON TOBACCO PRODUCTS, 1967

Province	*Type of Act*	*Cigarettes*	*Manufactured (packaged) tobacco*	*Cigars*
				per cigar
Newfoundland	Tobacco Tax Act	0.25¢ per cigarette	1¢ per ½ oz. or part thereof	6¢—15¢ : 1¢ 16 —25 : 2 26 —35 : 3 36 —45 : 4 over 45 : 5
Prince Edward Island	Health Tax Act	0.2¢	10%	6¢—19¢ : 1¢ 20 —29 : 2 over 29 : 3
Nova Scotia	Hospital Tax Act (sales tax)	0.1¢	5%	5%
New Brunswick	Tobacco Tax Act	0.2¢	10%	As for P.E.I.
Quebec	Tobacco Tax Act	0.24¢	12%	0¢— 5¢ : nil 6 —10 : 1¢ over 10 : 12%
Ontario	Tobacco Tax Act	0.1¢	1¢ per oz. for pkg. under 25¢ per oz. if more than 2 oz. or under 50¢ if less than 2 oz. 2¢ per oz. for pkg. over 25¢ per oz. if more than 2 oz. or over 50¢ if less than 2 oz.	For each 5¢ or part thereof of retail price: 0.2¢
Manitoba	Tobacco Tax Act	0.4¢	2¢ per ½ oz. unit	0¢— 7¢ : 1¢ 8 —12 : 2 13 —17 : 3 18 —22 : 4 23 —27 : 5 28 —32 : 6 33 —37 : 7 38 —42 : 8 43 —47 : 9 over 47 : 10
Saskatchewan	Tobacco Tax Act	0.2¢	1¢ per ½ oz. or fraction thereof	5¢—15¢ : 1¢ 16 —25 : 2 26 —35 : 3 36 —45 : 4 over 45 : 5
Alberta	NIL	NIL	NIL	NIL
British Columbia	Social Services Tax Act (sales tax)	5%	5%	5%

Source: Provincial Tax Reporters, Toronto: CCH Canadian Limited.

Manitoba clearly imposes the severest tax, the rate on cigarettes being quadruple that of Ontario. Quebec's tax, the third highest on cigarettes, is at a rate of 0.24¢ per cigarette compared to Ontario's 0.1¢. Comparisons with taxes in the United States are not so straightforward, since the rate imposed by the U.S. federal government is only about two-fifths that imposed by the Canadian federal government. Hence it is not the state taxes, amounting to 0.5¢ per cigarette in New York, and 0.35¢ in Michigan, that are important for our purposes, but the final, tax-inclusive price of cigarettes in those jurisdictions.

INCIDENCE

8. It is generally agreed that the demand for tobacco is price inelastic: consumption does not decline in proportion to increases in price. Even the recent spate of reports on the probable adverse effects of smoking on health have caused no drastic reduction in consumption. Accordingly, it is likely that increases in taxes on tobacco products will be borne by smokers, although suppliers may be affected, particularly in the short run. The bulk of tobacco is consumed in the form of manufactured cigarettes. Cut tobacco, for "roll-your-own" cigarettes and for pipes, is an alternative to which a number of smokers turn temporarily after price increases. The marketing of cigarettes is highly competitive, and consumers can offset some price increases by purchasing cigarettes by the carton rather than by the individual package. To the extent that these changes in buying habits occur, there will be some shifting of an increase in tax to suppliers. In the main, however, habits change little, or only briefly, and smokers, who would rather pay than switch, bear the burden of the tax.

9. Little can be said about the burden of the tobacco tax as it relates to income. Smoking is a habit common to all income groups, although the use of certain types of tobacco products may be concentrated in particular income classes. For example, someone who smokes an imported cigar is apt to be richer than the person who buys tobacco and papers to make his own cigarettes. We are convinced, however, that just as much tobacco tax is likely to be paid by one smoker as by another, whether poor or rich, and that over the whole scale of incomes the tax is bound to be broadly regressive.

JUSTIFICATION

10. There is no problem in justifying the use of a tobacco tax when, as in Ontario, tobacco products are exempted from a retail sales tax and the tobacco tax is levied at a rate approximately equal to the sales tax. As a matter of administrative convenience for taxpayers and collectors alike, the tax cannot be faulted. If pipes and lighters are taxed, so should tobacco be. The only question we shall consider is whether the tax might properly be raised above the level of the general sales tax. Certainly other governments, including some provinces, have imposed taxes on tobacco in excess of those on other products. Indeed, nearly half the final selling price of cigarettes in Canada accrues to the federal government because of its unusually high excises. The combined weight of the federal special excise tax

and excise duty, in addition to the sales tax, on a package of cigarettes represents about ten times that of the tax imposed by Ontario.

11. The criterion of equity provides no support for a discriminatory tax on tobacco. Since expenditures on tobacco bear no consistent relationship to individual incomes, a tax on this habit cannot be justified by the principle of ability to pay. Nor are there any identifiable government expenditures occasioned by smokers or undertaken on their behalf that could justify the tax on the ground of benefits received. That people *need not* smoke and can avoid the tax by abstinence is irrelevant to a discussion of the justification for imposing a levy. To describe tobacco as a luxury begs such questions as "How can luxuries be usefully defined?" and "Why aren't all luxuries taxed?" Discussions of these and similar questions, though often diverting, are unhelpful in supporting a tax. It has been suggested that, in the light of the evidence connecting smoking with health problems, the government could discourage the use of tobacco through taxation. But even if the health hazard were irrefutably proved—and we can only note that the connection is not universally accepted among experts—we could not support a tax on the ground of controlling behaviour. Taxes on tobacco, after all, are imposed first and foremost to raise revenue, and it would be an anomalous levy that is intended to destroy its own base. The promoting of such objectives as the health of citizens is best approached by government through direct regulation and control.

12. Although the usual rationalizations for a tobacco tax are weak, irrelevant or wrong-headed, this does not mean that it cannot be successfully supported. In the first place, a tax on tobacco satisfies most of the criteria we have established for a good tax. It is clear, simple, certain, easy to administer, and produces a substantial amount of revenue. In addition, it enjoys wide popular acceptance. No matter how varied or assailable their reasons may be, most people, including smokers, expect tobacco to be taxed at rates considerably higher than those applying to most goods. We do not argue that the defence of such a policy is to be found in terms of equity. It is simply that given the widespread social consensus governments may, within broad limits, exploit the tobacco tax with impunity.

CONCLUSION

13. We are quite convinced that the present Ontario tobacco tax is a useful, productive and equitable levy. Collection at the wholesale level has greatly improved administration, removing many vendors from the list of retail sales tax collectors, since the only taxable commodity they handled was tobacco. The existing rates are at levels corresponding to the rates that would apply if tobacco were taxed under the sales tax. Should more revenue be needed, this tax should be considered carefully. Demand for tobacco is relatively price inelastic, and an increase in tax would almost assuredly lead to increased revenue. With higher rates now prevailing in Manitoba and Quebec, Ontario is free to concentrate its attention on the price of tobacco in adjacent states. As long as the disparity in prices does not become too great, the Ontario tobacco tax could be increased.

THE HOSPITALS TAX

DESCRIPTION

14. The hospitals tax is a levy on expenditures made for amusements and entertainment in the province. The original intention, as the name implies, was that the revenue from this tax should be used to help finance hospitals; and in fact the moneys were so earmarked for the first two years following its introduction in 1948. By 1950 it had already become apparent that the needs of hospitals far exceeded the yield from the tax and it was decided that the requirements of hospitals should be budgeted for and financed like other expenditures. But, although the proceeds of the tax are deposited in the Consolidated Revenue Fund, the tax still bears the old name. The 1948 tax was not the first levy in Ontario on amusements: there had been a provincial tax from 1916 to 1937, and a federal tax was imposed during World War II and withdrawn in 1948. The hospitals tax was enacted to fill the gap when the federal government vacated the field.

15. Tax is payable on the price of admission to such amusements as cinemas, theatres, sporting events and concerts. A number of exemptions limit the generality of the tax. Events sponsored by a wide range of religious, educational, charitable or community organizations may be attended free of tax, as may amateur athletic events and exhibitions and grandstand performances presented by such organizations as the Central Canada Exhibition Association, the Royal Agricultural Winter Fair Association of Canada and the Canadian National Exhibition Association. Whether a particular event qualifies for exemption is left to the Treasurer's absolute discretion. Similarly, a theatrical or musical performance in a place of amusement may be exempted if the performers and the manager are Canadians. In this connection it has become departmental practice to exempt performances by Canadian companies even if foreign guest performers take part.

16. The tax on admission charges to places of amusement is at the rate of 10 per cent, half the rate that applied when the tax was introduced in 1948. An exemption is provided for amusements where the price of admission is less than 76¢, and a schedule of tax on admission charges from 76¢ to 92¢ applies, increasing gradually before the full 10 per cent rate is reached.

17. Tax is also payable by customers on the expenditure they make in a place of entertainment. Such an establishment is defined as a premises or place, whether enclosed or not, where facilities for dancing are provided with the service of alcoholic beverages, or where entertainment by one or more paid performers is provided with the service of food or of alcoholic beverages. For the latter purpose, if the entertainment is strictly instrumental music, not accompanied by a live vocalist, the performance does not qualify as "entertainment by one or more paid performers" and is exempt. In places of entertainment, once the entertainment has begun, customers are required to pay a tax of 10 per cent on all charges, including any cover charge and charges for food or beverages, subject to a maximum tax of one dollar per person. Restaurants or coffee houses that are not licensed to serve alcoholic beverages are required to collect tax when they provide live local entertainment, although some difficulty has been experienced in ensuring the proper

remittance of tax from some of these establishments. Food and beverages that are taxable under The Hospitals Tax Act are exempted from the retail sales tax.

18. Owners of places of amusement or entertainment collect the tax from patrons and remit it monthly to the Treasurer. The Act gives the Treasurer authority to compensate owners for their work as agents in collecting the tax, and a commission of 2½ per cent of the tax collected is allowed as remuneration. The Act is administered by the Hospitals Tax Branch of Treasury Department, which has a staff complement of 30 for this purpose. Most of the administrative difficulties arise from applications for exemption, which may number many hundreds in the course of a year, and from small or occasional operators who may be ignorant of, or delinquent in performing, their responsibilities for collecting and remitting the tax.

YIELD

19. Since the tax was introduced in 1948 the rate has been halved. Reductions were made in 1950 to 15 per cent, in 1951 to 12½ per cent, and in 1955 to 10 per cent. There has also been a gradual raising of the minimum admission charge that attracts tax. At the outset, in 1948, all charges were taxable. In 1950 charges of 15¢ or less were exempted, a figure that was raised in 1955 to 25¢, in 1962 to 57¢, and in 1964 to 75¢. These exemptions were designed to assist operators of small movie houses who suffered a severe decline in attendance that has accompanied the growth in popularity and availability of television.

20. These changes in rate of tax and in exemptions have, of course, had a considerable influence on the yield of tax, as have the changing patterns of expenditure on amusements and entertainment. Over the years the revenue from this tax has varied quite considerably, as is shown in Table 31:2. In recent years the yield has been growing steadily, and the net return for the fiscal year ending March 31, 1968, is expected to be $8.5 million, the largest in the history of the tax.

TABLE 31:2

YIELD, RATE AND MINIMUM TAXABLE ADMISSION CHARGE OF THE HOSPITALS TAX, SELECTED FISCAL YEARS, 1950-1966

Fiscal year	*Tax rate*	*Minimum taxable admission charge*	*Yield*
1950*	20%	16¢	$8,037,795
1951	15	16¢	6,289,533
1956	10	26¢	4,662,338
1961	10	26¢	4,218,448
1966	10	76¢	6,790,700

Source: Ontario, Public Accounts; and Treasury Department.

*First full year of tax.

21. Analysis of the hospitals tax revenue shows that admissions to motion picture shows constitute the largest single source of the tax, although recently there

has been a dramatic rise in the receipts from hotels and night clubs. The decline in popularity of motion pictures, and the effect of exempting low admission charges is reflected in Table 31:3 showing the sources of tax for selected years.

TABLE 31:3

SOURCES OF THE ONTARIO HOSPITALS TAX
SELECTED FISCAL YEARS, 1951-1966

	1951	*1956*	*1961*	*1966*
Motion pictures	$4,978,786 79%	$3,334,529 72%	$2,428,761 57%	$2,750,991 41%
Sporting events	$ 644,713 10%	$ 334,060 7%	$ 460,002 11%	$1,024,705 15%
Hotels and night clubs	$ 313,167 5%	$ 614,339 13%	$ 703,164 17%	$2,515,963 37%
Other	$ 352,867 6%	$ 379,410 8%	$ 626,521 15%	$ 499,041 7%

Source: Treasury Department.

COMPARISON WITH OTHER PROVINCES

22. Table 31:4 shows that taxes on amusements are levied in most, but not all, provinces of Canada. No taxes are imposed by British Columbia and Alberta. In Saskatchewan the province levies no tax, but has given its municipalities the right to impose a tax on admission charges at whatever rates and with whatever exemptions they see fit. In Quebec the municipalities are required to collect a 10 per cent tax on admissions, and until recently the province shared in these proceeds. Again in Quebec, tax on food and drink expenditures in places of entertainment is limited to the general tax on meals. Manitoba, New Brunswick, Nova Scotia and Prince Edward Island all levy amusement taxes with fixed amounts of tax set for price ranges up to $1, and a formula given for tax over that price. In Manitoba the rate for charges over $1 is 10 per cent, in New Brunswick 11 per cent, and in the other two Maritime provinces it is 5¢ for each 50¢ or part of 50¢. Newfoundland charges a 5¢ tax in respect of all admissions regardless of their prices. From this brief survey of Canadian practice three things are clear: no two taxes are identical; Ontario's exemption of admissions under 76¢ is the most generous exemption in the country; and Ontario is the only province to levy a special tax on food and drinks served with entertainment.

INCIDENCE

23. The intent of The Hospitals Tax Act is clearly that the tax should be borne by consumers, the patrons of places of amusement or entertainment. In addition, it is assumed in most incidence studies that commercial enterprises will try to shift taxes to consumers if possible. There are some features of this particular tax, however, that suggest that the entire burden may not be borne by patrons.

24. A large part of the tax revenue is derived from motion pictures, a form of recreation that has suffered a marked decline in popularity. Table 31:5 shows the number of cinemas and the number of paid admissions over a decade and a half.

TABLE 31:4

PROVINCIAL RATES OF TAX AT PLACES OF AMUSEMENT AND ENTERTAINMENT, 1967

Province	*Tax rate on admissions to places of amusement*	*Tax rate on charges in places of entertainment*
Newfoundland..............	5¢ per admission	Nil
Prince Edward Island.........	0¢— 30¢ exempt	Nil
	31 — 40 2¢	
	41 — 45 3	
	46 — 60 5	
	61 — 75 7	
	76 —$1.00 10	
	Over 1.00 5¢ for each 50¢ or part	
Nova Scotia................	0¢— 55¢ exempt	Nil
	56 — 70 5¢	
	71 —$1.00 10	
	Over 1.00 10¢ and 5¢ for each 50¢ or part	
	Theatres	
New Brunswick	0¢— 25¢ 2¢	Nil
	26 — 30 3	
	31 — 40 4	
	41 — 45 5	
	45 — 50 6	
	51 — 60 7	
	61 — 70 8	
	71 — 80 9	
	81 — 90 10	
	91 —$1.00 11	
	Over 1.00 —11%	
	Others	
	0¢— 25¢ 2¢	
	26 — 50 5	
	51 —$1.00 10	
	Over 1.00 — 5¢ for each 50¢ or part	
Quebec....................	10% collected by and for municipalities	8% under the Meals and Hotels Tax Act
Ontario....................	0¢— 75¢ exempt	10% to a maximum of $1.00
	76 — 84 6¢	
	85 — 90 7	
	91 — 92 8	
	Over 92 10%	
Manitoba..................	0¢— 60¢ exempt	Nil
	61 — 64 1¢	
	65 — 67 2	
	68 — 70 3	
	71 —$1.00 5%	
	Over 1.00 10%	
Saskatchewan..............	Municipal by by-law	Nil
Alberta.....................	Removed 1959	Nil
British Columbia............	Nil	Nil

Source: Provincial Tax Reporters, Toronto: CCH Canadian Limited.

Table 31:5

CINEMAS AND PAID ADMISSIONS IN ONTARIO, SELECTED YEARS, 1950-1965

Year	*No. of cinemas*	*No. of paid admissions*
1950	528*	96,664,000
1955	602	74,417,000
1960	462	44,976,000
1965	385	39,755,000

*Figure does not include drive-in theatres or halls used for showing motion pictures.

Source: Dominion Bureau of Statistics, *Motion Picture Theatres and Film Distributors.*

25. Clearly with the drastic drop in attendance and the closing of a large number of cinemas, the industry has not been in a strong position to pass on the tax, and has probably absorbed at least part of it. Again, since the price of tickets is almost invariably set at a "round" figure, it is improbable that the full benefit of the removal of the tax would accrue to the customers. Indeed, we suspect that most prices would remain the same, with the operators getting the benefit of a reduction if the tax were lowered. On the other hand, it is likely that a large increase in the tax would be passed on to the consumers, at least in part.

26. In this connection it is significant that exemptions are granted to certain types of event. The manner in which it is done suggests that it is the promoters of the event who get, and hence benefit from, the exemption, rather than the patron.

27. The tax paid at places of entertainment is probably borne by patrons in large part. The common practice is to add the tax to the bill, in the same way that the retail sales tax is added. Although it may be that prices for food and beverages in some of these establishments would be raised by the amount of the tax reduction if the tax were removed, most would remain the same. Indeed, many of these places operate part of the time without entertainment, when their services are subjected only to sales tax, and part of the time with entertainment, when hospitals tax is exigible.

28. There is little evidence to suggest that the tax is relatively more burdensome on any particular income class. Entertainment expenditures seem to absorb a relatively constant proportion of family income over the broad range of income groups, although differences may be great between individual family units. Single men probably pay a disproportionate amount of this tax. As the amount of tax paid by any one taxpayer is relatively so small, the question of incidence among income groups is unimportant.

JUSTIFICATION

29. A specific tax on amusements and entertainment is impossible to support on grounds of equity. Certainly one cannot point to any expenditures made by the government that could justify the levy or any significant fraction of it. And because the incidence of the tax is somewhat uncertain, particularly in relation to that part

of the tax collected for admissions to amusements, the hospitals tax cannot be justified on the grounds of ability to pay. But a tax that has a steadily increasing yield, as has been experienced in recent years, and is collected economically and without apparent objection from the public, is not to be lightly discarded.

30. In our view the major objection to the present hospitals tax is that it is blatantly discriminatory. It discriminates broadly against one class of expenditures, a class that incorporates a large portion of those events that comprise the formal culture of our society. Indeed the existing tax laws of the Province are such that a strange anomaly results. A book containing the libretto and score of an opera such as *The Barber of Seville* can be purchased free of tax. A record of the same opera attracts the 5 per cent sales tax, but a live performance by a company such as the Met can be enjoyed only after paying the 10 per cent hospitals tax. Video tapes of that performance could be broadcast and enjoyed in thousands of homes free of any tax, but a movie of it, shown in a cinema, would be taxable if the price of admission were more than 75 cents.

31. The present hospitals tax is discriminatory in another sense, too. The wide range of exemptions creates obvious inequities. Canadian theatrical or musical performances can be enjoyed without tax, but not those of foreign artists unless the proceeds are to be used for charitable, religious or educational purposes. Tax is paid to see daredevil car drivers, unless their performance is part of a recognized grandstand show. Old Satchmo may blow his horn to an untaxed nightclub audience, but he may not sing. If he does sing, the first ten dollars a patron spends will be taxed, but further expenditures will not. At a concert performance his audience is taxed whether he sings or not. The various degrees of professionalism of hockey teams must be explored to determine whether tax will be charged, or, if it has been collected, whether it may be refunded. A $1 admission charge for an evening movie is taxable; a 75¢ matinée ticket for the same movie is not. Although many of these inequities could be removed by a rationalization of the statute, we think that the exemptions testify to a realization of the unfairness of taxing certain forms of entertainment at the high rate of 10 per cent.

CONCLUSION

32. As indicated above, we reject the notion that a special tax should be levied on certain forms of amusement and entertainment. Levied at a rate higher than is applicable to most consumer expenditures, the tax is unfair; the exempting of many events similar to those that are taxed makes it inexcusable. In our view, expenditures made for amusement and entertainment should be taxed under the general sales tax like other consumer expenditures. If this were done the need for exemptions would be done away with and an annoying source of blatant discrimination removed from the tax system of the Province. Accordingly, *we recommend that:*

> ***The Hospitals Tax Act be repealed and all expenditures on amusements and entertainment be taxable under the retail sales tax.*** **31:1**

THE RACE TRACKS TAX

DESCRIPTION

33. Since 1922 Ontario has had a levy on pari-mutuel betting at horse races. Until 1939 the tax was a part of The Corporations Tax Act; subsequently it has been under a separate statute, The Race Tracks Tax Act. Under both Acts the tax has been levied on the holders of winning tickets. Since no other form of betting is permitted the tax is levied on all legal wagering in the province. That there is some illegal betting activity, on horse races and other events, is unquestioned, but its extent is unknown. The Province has never attempted to broaden its race tracks tax to tax any wagering other than by pari-mutuels, even in the period before 1951 when betting on harness racing was conducted through bookmakers.

34. The level of tax, described in the statute as "at the rate of 5 per cent or such other rate as the Lieutenant Governor in Council prescribes" is now fixed at 6 per cent. The person holding the race meeting acts as a collector for the Province and turns over the proceeds. Calculation of the tax is simplicity itself. The amounts wagered on each race are added automatically by the pari-mutuel machines, or totalizators, and the tax is 6 per cent of the total pool of wagers before any deductions are made. In addition to this tax on betting, the Act imposes a tax on every person owning or operating a race track and holding a meeting, of $1 for each day of the race meeting.

35. Historically the rates of the tax have varied widely, from a low of 5 per cent in the period to 1943, to a high of 14 per cent on certain pools in 1951 and 1952. In the years 1951 and 1952 the rate of tax varied according to the size of the pool; before and since that time a flat rate has been used. Prior to the use of multiple rates the tax was gradually increased; since then it has decreased, from 8 per cent in 1953, to 7 per cent in 1954, and to the present 6 per cent in 1956.

YIELD

36. After a period of slow but steady growth, the yield of the race tracks tax has recently been rising rapidly. From a total return of just under $4 million in the 1956 fiscal year, the yield grew to over $5.7 million in 1961, and nearly $12.2 million in 1966. The forecast for 1967-68 is for a yield of $14.5 million. Thus, although the tax does not finance a large portion of the Province's expenditures, it does provide a substantial and growing revenue.

37. The single most important factor in the increase of the yield from this tax is the rapidly growing popularity of harness racing. Whereas in 1956 wagering on harness races contributed only 4 per cent of the total, in the 1966 calendar year it actually exceeded the amount from betting on running races, and contributed 54 per cent of the total. Simultaneously, betting on running races has increased, at a more gradual pace. With the advent of year-round racing—meetings are held somewhere in the province in each of the 12 months—we can expect the growth of this tax to continue, although the rate of increase may not be maintained indefinitely.

INCIDENCE AND JUSTIFICATION

38. There is uncertainty as to who actually bears the burden of the tax. Undoubtedly the holders of winning tickets, who are charged in law with paying the tax, leave the pay wickets with less to put on the next race than they would in the absence of the tax. On the other hand, all wagers are affected by the tax. By reducing the odds of each bet, the tax has the effect of giving a bettor less for his two-dollar wager. All punters, therefore, bear some burden. We have heard a suggestion that the tracks or the horsemen suffer from the tax as it makes less money available for profits and purses. This argument ignores the fact that the level of deduction the track is allowed to take is limited by the Criminal Code. If the Province abolished its tax entirely, the tracks would still not be able to increase their take without an amendment to the federal statute.

39. Regardless of who actually bears the tax, bettor or winner, it is well-nigh impossible to justify the tax on the classic grounds of equity. Nor is there anything to suggest that the fans receive the benefit of any government services provided specifically for them. In fact a considerable amount of regulation, supervision and inspection is done, but the cost is mainly, and should be entirely, recovered through fees charged by the Ontario Racing Commission to the tracks, trainers, jockeys and others involved in racing. These charges are presumably financed by patrons through admission charges and the track's portion of the betting pool. Similarly it is trivial to suggest that betting or winning is a clear indication of ability to pay. As a group, bettors in Ontario lose 15½ per cent of their wagers. There is no way of distinguishing bets placed by the poor who are desperate from those placed by the rich who seek diversion. Both exist. Nor can the people in line before the pay wickets be readily separated into the shrewd, consistent winners and the occasionally lucky, over-all losers. As long as losses are not taken into account, winnings cannot be used as evidence of ability to pay.

40. There is no doubt, however, that wagers or winnings at the track certainly provide a ready source of funds that can be taxed. By insinuating itself into the circulation stream, the Province is in a position to draw off its 6 per cent quickly, quietly and efficiently. The tax is simple, certain, clear and painless. There is almost universal agreement that gambling is a suitable object of taxation. We share that view. Confronted with very rapidly expanding revenue requirements, the government would be ill-advised to forgo this revenue.

RATE

41. When considering the rate of the race tracks tax, one must keep in mind the other deductions made from the betting pool. The most important is the amount withheld by the track: 9 per cent, fixed by the Criminal Code of Canada. In addition, the federal government levies a tax of ½ per cent, which is justified on the grounds of reimbursing Canada for the supervision it provides. Until 1952 the rate of the track take varied inversely with the size of the betting pool, but has since been fixed at the present level. The federal tax was introduced in 1940 at 5 per cent, abolished entirely in 1948, and reimposed at ½ per cent in 1955.

42. Of greatest significance is the combined total of the deductions made from the betting pool. A large proportion of the total betting at Ontario tracks—in fact, 42 per cent in 1966—is done at locations close to provincial borders, where some unknown but large number of patrons are not residents of the province. Three tracks, Fort Erie, Garden City and Windsor, keep a separate pool for wagers made in U.S. funds, so that bets can be made and paid out in U.S. currency without bothering with exchange. It is safe to assume that only Americans contribute to the U.S. pool, or at least that they contribute the overwhelming proportion. They may also contribute to the pool of Canadian funds. Thus the U.S. pool is a minimum figure for non-resident wagering at those tracks. In 1966 the U.S. pool at the three tracks was 55 per cent of the total, at Windsor it was 73 per cent. Thus it is a matter of importance to ensure that the total deductions from the pool do not become so large as to discourage people from Quebec, New York and Michigan from patronizing Ontario tracks. Our rates must never exceed our neighbours' by a significant amount.

43. The total size of the take is important from the point of view of the acceptability of pari-mutuel betting, too. It is widely believed that after a certain point the deductions made from the pool will encourage bettors to use bookmakers whose rate of profit will not be so high as the total take at the track. Indeed, the reason given by the Treasurer for reducing the rate of tax in 1952 was "to curb illegal betting".[2]

44. In the light of all these considerations we think that the present rate of 6 per cent is reasonable, giving as it does a combined deduction from the pool of 15½ per cent. This is ½ per cent higher than is taken in the neighbouring states of New York and Michigan. Quebec uses two different rates: winning tickets on a single horse are subject to a 7 per cent tax; others, such as those for the daily double or quinella, carry a 9 per cent tax. Comparatively, then, Ontario's rates are close to those of its neighbours, a position we think should be maintained.

45. The Quebec Royal Commission on Taxation recommended that the tax be applied at rates that increase as winnings increase. Thus for a $2 bet that pays up to $5 the tax would be 7 per cent, for winnings from $5 to $25 it would be 8 per cent, and so on. The Quebec Commission gives no estimate of the revenue implications of such a change, nor do they examine the administrative problems the scheme might cause for the tracks. Certainly the essential simplicity of the tax would suffer. We did not see fit to undertake the rather extensive research that would be necessary to make confident estimates of the effects of a progressive tax. In our view Ontario should consider such a scheme only after careful examination of its successful introduction in some other jurisdiction.

CONCLUSION

46. The race tracks tax is a useful and productive levy that Ontario should continue to exact. The most appropriate rate at any time will be influenced by practice in neighbouring jurisdictions and by the percentage take allowed to track

[2]Budget Address, Hon. L. M. Frost, Treasurer of Ontario, 1952, p. 33.

operators. The current rate of tax in Ontario seems quite appropriate to existing circumstances.

47. One aspect of the tax deserves specific mention—the requirement of a $1 payment for each racing day. This feature was put in the legislation long before the Ontario Racing Commission was established and started charging significant fees. Essentially a licence fee, it no longer serves a useful purpose and has now no place in the taxing statute. The revenue it raises is insignificant. Accordingly, *we recommend that:*

> ***The tax, on a person holding a horse racing meeting, of $1 for each day of racing, be abolished.*** **31:2**

THE SECURITY TRANSFER TAX

DESCRIPTION

48. Since 1911 Ontario has exacted tax on the change of ownership of securities by a levy against the vendor or transferor. Although in 1939 it was taken out of The Corporations Tax Act, under which it was first imposed, there have been only very minor changes in the tax throughout its history. The rate varies with the value and nature of the security and results in an effective rate of tax that ranges between 0.03 and 0.25 per cent of the value of the security. The Act imposes one set of rates on bonds, debentures, debenture stocks, syndicate units, mineral deeds, oil royalties, guaranteed trust certificates and investment receipts, and another set on shares. The actual rates are shown in Table 31:6. These rates of tax are the same as those that apply in Quebec, the only other province levying a security transfer tax.

TABLE 31:6

RATES UNDER THE SECURITY TRANSFER TAX ACT, 1967.

Security	*Tax*	*Effective tax rate as per cent of price*
Bonds, debentures and debenture stock: Each $100 of par value or fraction thereof	3¢	.03%—.06%
Syndicate units, mineral deeds, oil royalties, guaranteed trust certificates and investment receipts: Each $100 of price or value, or fraction thereof	3¢	.03 —.06
Shares		
—at price or value under $1.00	1/10 of 1%	.10
$ 1.00—$ 5.00	¼¢ per share	.05 —.25
5.01— 25.00	1¢ per share	.04 —.20
25.01— 50.00	2¢ per share	.04 —.08
50.01— 75.00	3¢ per share	.04 —.06
75.01—150.00	4¢ per share	.03 —.05
over $150.00: first $150	4¢ per share	.03
excess over $150	1/10 of 1%	.10

49. The determination of what constitutes a security for the purposes of the tax is dealt with in the Act and the Regulations. Despite the definitions, there are still some distinctions that are left to departmental practice. A good example is

the short-term paper issued by corporations. The Department treats as taxable all notes and other instruments that, because of the security attached to them, are deemed to have the nature of a bond or debenture. Other notes are not taxable. The result is that certain short-term notes attract a transfer tax of 3¢ per $100, which on a 90-day note approximates the dealer's normal spread. Because of the impact of the tax there is for all practical purposes no resale or "after-market" potential for such notes, with the result that even the market on original issue is weakened.

50. Several types of securities and some methods of transfer are exempted under the statute. Securities issued or guaranteed by the federal or provincial government, or by Ontario municipalities and school boards are exempted—a a preferred treatment for which we can find no justification. There is an exemption for the first issue of securities that extends to an underwriting by a group or syndicate of dealers. But transfers within the underwriting group other than those required to carry out the syndicate agreement are taxable, with the result that in some instances tax is payable before the primary distribution of an issue of securities is completed. One regulation sets out thirty-four sets of circumstances in which transfers are not taxable because beneficial ownership has not really changed.

51. Tax is imposed on a person transferring securities if the change in ownership takes place within Ontario. When an order is placed in the province and the sale is executed elsewhere, the order is taxed. If a delivery of securities held in Ontario is made in Ontario on a sale for the account of a non-resident, the delivery is taxed. An exchange of securities, except in the course of a reorganization of capital structure, is also taxed. Even a payment made in Ontario for securities sold outside Ontario falls within the ambit of the tax. Because the statute does not define a "sale, transfer or assignment" that gives rise to tax, complex regulations have been developed setting out what are, and what are not, taxable transactions.

52. When a taxable transfer occurs, a security can usually be valued at the transfer price, but if there is no actual sale, current market value is used. Where neither of these methods of valuation can be applied, the Treasurer may fix a value for purposes of the tax, most often by determining the book value of the security on the basis of the most recent annual financial statement.

53. The largest portion of the security transfer tax is collected by members of the Toronto Stock Exchange—over 50 per cent in the 1967 fiscal year. Broker-dealers, banks and trust companies also regularly collect the tax as agents of the Treasurer. Although these organizations have reported that their role in this regard creates inconvenience and is probably not fully reimbursed by the 3 per cent commission, it is unlikely that any significant amount of tax is missed by these institutions, and audit is straightforward. The transfers of securities of private companies not using transfer agents present quite a different problem to the tax administrators. Frequently the tax is overlooked in these transactions and the Treasury Department has to perform awkward, expensive audits in search of what are often very small amounts of tax. Such audits in respect of security transfers have been likened by

one unkind wag to a thief looking for change under cushions in a house full of gold furniture.

54. Indeed the total revenue produced by the security transfer tax is not great in relation to the total receipts of the government. The yield of the tax for the period 1958-1966 is shown in Table 31:7. One factor that has a marked influence on the yield is, of course, the amount of activity on the stock exchange.

TABLE 31:7

YIELD OF THE SECURITY TRANSFER TAX, SELECTED FISCAL YEARS, 1958-1966

Fiscal years	*Yield*
1958	$2,631,481
1960	2,530,228
1962	3,534,875
1964	3,086,140
1966	4,199,648

Source: Ontario, Public Accounts.

INCIDENCE

55. The security transfer tax is paid by the vendor. In some instances, we are told, the tax is actually borne by the buyer or the transfer agent, although the proportion of the tax paid in this manner must be very small. It is unlikely that those who pay the tax will have an opportunity to pass the tax on to others; certainly individuals will not have such a chance. Corporations probably treat the tax as a reduction of the proceeds from the sale of securities, thereby decreasing profits from such sales. Because the tax is so small, we doubt that it will have any significant effect on the price of securities.

56. Clearly, then, the tax is imposed on people who have shares and other securities to trade; such people tend to be the rich. Our study of the composition of Ontario taxable estates indicates that people with large estates have higher incomes and a larger proportion of their assets in securities than do those with smaller estates. Even though this evidence suggests that the tax is borne mainly by the rich, it is impossible to say that the burden of the levy is positively related to income, since the tax is payable on the transfer, not the ownership, of securities. Indeed our study showed that larger estates hold, on average, an increasing proportion of their assets in the form of securities without independently quoted values—securities that would be unlikely to be traded. In conclusion, then, we can only say that the tax is probably borne by people with fairly high incomes and in proportion to the amount of trading in securities that they do directly, or that is done by companies whose shares they own.

JUSTIFICATION

57. From the preceding discussion of its incidence it will be clear that the security transfer tax cannot be justified on the grounds of ability to pay. Nor does

the principle of benefits received provide a rational basis for the tax. Although the tax is handled by a small staff in Treasury, it cannot be said to have the simplicity, clarity and certainty that justify some revenues. Its yield is small, and the inconvenience to collectors is great. Like a boat in a farmer's field, it is hard to explain why it is there.

CONCLUSION

58. In our opinion the security transfer tax is a nuisance tax that should be abolished. The exchange of wealth in the form of securities, for an equally valuable asset in another form, usually cash, is not a transaction that should be subject to tax.

59. We do suggest, however, that if services are to be taxed under the retail sales tax, the commissions charged by security brokers and dealers should be taxable. This proposal should not be thought of as an alternative to the security transfer tax, but rather as a logical and equitable part of the broadening of the sales tax base to services. To prevent a disruption of the money markets, the proposed tax should not be applied to commissions on underwritings and primary distributions. For certain kinds of transactions, such as typical bond dealings, brokers do not charge a commission *per se,* but rather rely on obtaining a "spread" —the margin of profit of selling price over cost. These spreads will vary widely according to the type of the security and the condition of the market at the time of sale. Indeed, a dealer may sell at a loss. In assessing sales tax on transactions such as these it would be necessary to deem a rate of commission in keeping with the nature of the security and the kind of transaction. The treatment of commissions on orders from investors outside the province should be similar to the treatment for other services performed in Ontario for non-residents.

60. The effect of such a change on the revenue should not be great. Certainly some transfers taxed under the present Act would not be taxed under the retail sales tax. Transactions by brokers and dealers, now accounting for over three-quarters of the tax, would still be subject to the tax. Indeed, under the sales tax the levy would apply to both sides of the transaction. Although we find it impossible to make any definitive statement, we think that the sales tax on the commission charged by a broker on the Toronto Stock Exchange would be roughly equal to the transfer tax now exacted. Thus, with the sales tax levied on the commissions charged to both buyer and seller, we think that the yield from taxable transactions may increase. We expect, therefore, that the net effect of our recommendations will be an increase in revenue to the Province.

61. In keeping with the foregoing, *we recommend that:*

The security transfer tax be abolished, and commissions charged by security dealers and brokers for their services be taxable under the retail sales tax; and for this purpose, where no commission is charged by a security dealer or broker, a reasonable commission be deemed to have been charged. **31:3**

THE LAND TRANSFER TAX

DESCRIPTION

62. Taxation of transfers of land was introduced in Ontario in 1921 with the enactment of The Land Transfer Tax Act. No other province has a land transfer tax, although such a levy is used by the United States federal government, some states and at least one city. The statute is simple and short, there are no Regulations but there are departmental rulings. Tax is to be paid by every person who tenders for registration a conveyance, deed, transfer or other instrument or writing whereby land is to be granted, assigned, conveyed or otherwise transferred. The bulk of the tax is collected by land registry and land titles offices. In some instances, where the amount of tax is in doubt or there is a desire for secrecy, the tax is paid directly to the Treasury Department. In either event the tax must be paid before a transfer will be registered.

63. Until April 1, 1966, the rate of tax had for years been 0.2 per cent of the consideration given. At that date the rate was increased to 0.4 per cent for that part of the consideration in excess of $25,000; the rate for amounts up to $25,000 remained unchanged. Prior to the change in rate the yield of the tax had been growing gradually, if not steadily, as Table 31:8 indicates. At the time of writing, final figures are not available for the 1967 fiscal year, but the forecast based on experience in the first eight months indicated that revenues should be approximately $8.5 million. It can be expected that as land values increase, and activity in the real estate market grows, the yield of the land transfer tax will rise. A lull in the real estate boom would, however, be reflected in a lower yield from the tax.

TABLE 31:8

YIELD OF THE LAND TRANSFER TAX,
SELECTED FISCAL YEARS, 1958-1966

Fiscal years	*Yield*
1958	$3,413,192
1960	4,130,799
1962	3,709,969
1964	4,474,931
1966	6,705,592

Source: Ontario, Public Accounts.

64. The departmental rulings, while they have no legal authority, are of major importance to anyone acquiring land, since the transfer cannot be registered until tax is paid, and the only appeal from the interpretation of these rulings is to the Treasurer. The rulings deal with three broad subject matters: the definition of land and of transactions subject to tax; the determination of consideration or value subject to tax; and the treatment of non-arm's-length transactions. From submissions made to us and from our own study we have concluded that the rulings lead to an unfortunate degree of uncertainty and arbitrariness. Three examples will suffice. Confusion and varying interpretation can only result from the ruling

that leases for a "period less than a lifetime (approximately 50-60 years)" are not taxable, while those for a longer period are treated as taxable sales. Second, the treatment of assignments of agreements for purchase and sale of land varies from office to office. Finally, we question the equity of refusing any refund of tax where the consideration payable is subsequently refunded in part. So long as many of these difficulties are not overcome by the promulgation of carefully considered Regulations, they create unjustifiable uncertainties and inequities in the operation of the tax.

INCIDENCE

65. It is hard to make any useful comments about the incidence of the land transfer tax since we have no idea of the relative portions paid by individuals and by businesses. Individuals have little prospect of passing the tax on, although there may be some instances where theoretically the necessity to pay tax lowers the price they are willing to pay for property. Because the tax is so small, we doubt that this happens very often, if ever. Most of the tax paid by businesses probably results in slightly lower profits for owners, but property acquisitions are infrequent occurrences in most enterprises. At best it is considered a part of capital cost to be recovered over a period of time through the prices charged for goods and services.

66. It is probably true that the portion of the tax paid by individuals is borne by people of some substance. But values of homes in relation to incomes tend to decrease as income rises, leading us to assume that the land transfer tax is regressive in relation to income for those who pay it. The higher rates now applicable on the portion of the consideration over $25,000 have undoubtedly mitigated the regressiveness of the tax.

JUSTIFICATION

67. On grounds of equity it is impossible to justify the land transfer tax. For individuals, the time of purchase of real estate is seldom the time when they have the greatest liquidity or capacity to pay tax. To suggest that the action of buying real estate indicates an ability to pay, and that the purchases of this commodity are good measures of such ability, is nonsense. If, as we conclude, the ownership of property is not a particularly accurate index of ability to pay, the act of purchasing property is worse. And to the extent that property is bought by businesses the concept is entirely inapplicable. Similarly there are no benefits bestowed on property purchasers by government that are not already paid for through fees charged by land titles and registry offices.

68. The tax is not an abundant producer of revenue, although the yield is far from insignificant. Simplicity, clarity and certainty are not leading features of the tax because of the sometimes vague wording, and occasionally differing interpretations, of the rulings issued by the department. We think the rulings could be superseded by more precise Regulations, however, and the tax made clearer and more certain. In short, we think that the tax on transfers of land is a poor one, and that the other Canadian provinces are wise in not having one.

CONCLUSION

69. If the land transfer tax is to be kept, it should be given careful and skilled attention to remove many of the annoyances and uncertainties. The departmental rulings should be replaced by comprehensive regulations that would offer an effective opportunity of appeal to those subject to tax. We would prefer, however, that the tax be abolished entirely.

70. On the other hand, if other services are to be taxed under the retail sales tax, then the services of real estate agents, like those of security dealers and brokers, are proper subjects for taxation. If real estate commissions were earned only in connection with transfers of land, a case could be made for keeping some of the features of the land transfer tax, such as collection at land titles and registry offices, and the use of affidavits. In actuality, however, real estate agents earn commissions in connection with such matters as leases, which are frequently not registered. Hence it will be necessary to treat real estate agents like others providing services and collect the sales tax directly from them.

71. In accordance with the foregoing, *we recommend that:*

The land transfer tax be abolished and that commissions charged for services by real estate agents be made subject to the retail sales tax. **31:4**

TAXES ON INSURANCE PREMIUMS

DESCRIPTION

72. Insurance taxes are imposed under three separate statutes; The Corporations Tax Act, The Insurance Act and The Fire Marshals Act. The taxes under the first two statutes are similar, being levied on insurers at a rate of 2 per cent of gross premiums. With by far the larger yield, the first of these applies to insurance operations on premiums for all forms of insurance. The second applies only to reciprocal and inter-insurance exchanges.[3] The third tax in the group, that levied under The Fire Marshals Act, applies to all payments in respect of fire insurance except those for re-insurance, premiums returned, and dividends paid to policyholders by mutual companies and reciprocal exchanges. The tax is additional to the other taxes on insurance, and is levied at a rate of ⅔ of 1 per cent. Nominally the fire marshals tax is earmarked to finance the operations of the Office of the Fire Marshal, but in fact it is paid into the Consolidated Revenue Fund like all other taxes.

73. Even before World War II the provinces were actively taxing insurance. Under the terms of the war-time federal-provincial tax rental agreement of 1940, however, the provinces withdrew in favour of the federal government, which levied tax at the rate of 2 per cent of premiums. In 1956, when the federal government abandoned the field, all the provinces introduced remarkably similar legislation imposing a uniform 2 per cent tax. No similar uniformity exists with the tax under

[3]Reciprocal and inter-insurance exchanges are organizations through which persons agree to pool their resources and risks using deposits in much the same manner as premiums.

The Fire Marshals Act. Neither Quebec nor Prince Edward Island levy an extra tax on fire insurance, and in the other provinces the rates vary greatly. The highest rate is used by Newfoundland, 8 per cent, the lowest by Alberta, ⅓ of 1 per cent.

74. All three Ontario statutes exempt from the the base those premiums that are returned or cancelled, many premiums in respect of re-insurance, dividends, and savings paid or credited to policy holders or subscribers to an exchange. No tax is levied in respect of marine insurance under The Corporations Tax Act, no doubt because of the ambulatory nature of ships. The Corporations Tax Act levies no tax calculated with respect to gross premiums that become payable to mutual insurance companies insuring agricultural and other non-hazardous risks on the premium note plan if their business is carried on solely within Ontario, fraternal and mutual benefit societies as defined in The Insurance Act, and pension fund and employees' mutual benefit societies incorporated under or subject to The Corporations Act.

75. Careful definitions of what constitutes business transacted within the province have been developed and correspond to those used in other provinces so that problems of double taxation are largely avoided. A fine example of co-operative federalism at work is the administration of the tax on licensed insurance companies. The federal government sends copies of reports of these companies and subsequent changes to Ontario's Treasury Department which then distributes copies to other provinces that are interested. Thus the co-operative audit insures that any premiums deducted by a corporation in the computation of tax for one province are taxed in another province. In this way loss of tax is avoided without costly duplication of audits.

YIELD

76. The yield of the three taxes on insurance is not great, relative to the total needs of the Province, but is large enough to be useful and stable enough to be dependable. The growth of the revenue over the long term should reflect changes in both population and the value of money. The actual amounts collected under these taxes for the period 1958-1966 are shown in Table 31:9.

TABLE 31:9

ONTARIO REVENUE FROM TAXES ON INSURANCE PREMIUMS, SELECTED FISCAL YEARS, 1958-1966

	Under The Corporations Tax Act			*Under The Insurance Act*		*Under The Fire Marshals Act*
Fiscal year	*Life insurance*	*Fire insurance*	*Automobile and other*	*Exchanges*	*Unlicensed companies*	*Fire insurance*
1958	$4,318,682	$1,278,490	$4,118,032	$ 6,346	Nil	$669,189
1960	5,235,048	1,198,312	5,951,503	10,054	$ 26	563,117
1962	3,700,326	1,231,692	9,151,938	12,866	60	586,360
1964	6,078,662	1,727,845	5,878,316	18,366	2,319	586,066
1966	5,902,814	1,292,644	10,835,559	21,331	2,592	715,416

Source: Ontario, Public Accounts; and Treasury Department.

Because of the statutory constraint to relate the expenses of the Office of the Fire Marshal to the yield of the fire marshals tax, it is interesting to note the relationship of expenditures of that office to the revenue. Over the past few years there has been a net surplus of revenue over the direct expenditures of the office. It is not known whether the surplus would survive if overhead administrative costs such as full space rental, personnel services and superannuation contributions were charged to it. In any event the surplus is so small that a fractional adjustment of the rate for one year would correct the balance for several years. Hence it seems that the intent of the statute is being honoured.

INCIDENCE

77. Theoretically, under conditions of perfect competition the entire tax on premiums is borne by policy-holders. If competition is imperfect, some of the burden will be borne by the insurers. To the extent of the business done by mutual companies, the distinction is irrelevant. For the rest, we have been unable to make any confident estimate of the degree of imperfection of the competition in the insurance industry and hence of the amount of tax that may not be passed on in the form of higher premiums. It is our opinion, however, that the overwhelming preponderance of the levy is reflected in higher premiums. A goodly portion of the premiums will be paid in the first instance by businesses, which will do all they can to recover these costs in the prices of the goods and services they sell. There are no figures that give a fully accurate indication of the proportion of insurance premiums paid by business; hence the exact distribution of the burden of the taxes remains in doubt.

78. Regardless of the incidence of the taxes, we doubt that the matter is of great import. The total yield is not of such a magnitude that the over-all equity of the revenue system would be seriously jeopardized even if the taxes on premiums were dramatically regressive, which we doubt.

JUSTIFICATION

79. For years, life insurance companies have been given special, preferential treatment under income tax legislation. Because their taxable income base is calculated differently from that of other businesses, it has been argued that a special tax on life insurance premiums can be justified. This argument can be extended to support a premiums tax in respect of mutual companies and societies, since they are exempt from the corporations tax. Such reasoning, however, would imply that premium taxes make taxation of all insurance similar and comparable with the taxation of other businesses. This is not so, although the taxes do ensure that the insurance industry contributes more to the public purse than it would do otherwise. In our view, the justification for the taxes in the present tax structure must depend on simplicity and certainty, and on the dependable revenue they produce.

80. Once a sales tax is levied on services as we propose in Chapter 29, however, it is possible to justify a tax on insurance premiums on the basis of equity. Insurance, like dry-cleaning, is a service for which many people are prepared to pay. The premium, or charge for the service, can be thought to be comprised of

two parts; the amount that pays for all administrative costs and profit, and the amount that is pooled to pay claims or is allocated as savings. It is the first portion of premiums that should be treated as a charge for a taxable service. The portion of premiums that is used to settle claims or is returned or credited to policy-holders as dividends or savings should not be taxed, as it is not an expenditure comparable to other expenditures taxable, or proposed for taxation, under the sales tax.

81. We have tried to determine the part of premiums that would be taxed if insurance were brought under the retail sales tax. For insurance other than life insurance, this involved establishing the portion of the net premiums retained by the industry after deducting all amounts paid or reserved for claims or losses. For life insurance the process is somewhat more complicated because the savings element must also be removed in order to arrive at the true service portion. The April 15, 1966, edition of *The Canadian Underwriter* gives Canada-wide figures indicating that the following proportions of premiums written are retained by the industry: life insurance, 47.5 per cent; fire insurance, 45.2 per cent; automobile insurance, 33.3 per cent, and casualty insurance other than automobile, 35.4 per cent.

82. These figures suggest that it might be appropriate to apply the 5 per cent sales tax to 45 per cent of premiums for life and fire insurance, and to 33⅓ per cent of those for other classes of insurance. This would be equivalent to imposing rates of 2¼ and 1⅔ per cent to the full premiums—actually very close to the present 2 per cent rate of tax on premiums.

83. There is, of course, an important difference in who is legally responsible for paying the premiums tax and the sales tax. The premiums tax is paid by insurers, the sales tax would be paid by policy-holders. If the tax were changed without a simultaneous government interference with the terms of existing contracts, removing the premiums tax might not be reflected in reduced premiums to policy-holders even though they would have to pay the new sales tax. This could be particularly onerous for people holding long-term life insurance contracts with fixed premiums. At the same time, to abandon the present premiums tax would be to disrupt the workings of a particularly smooth-running tax, and to forgo the significant advantages of the co-operative audit among provinces. We can find no benefits from changing the base for the tax that would offset the disadvantages. We think that the taxes should continue in their present form and that the rate of tax should be kept at a level that yields as much tax as would the retail sales tax if it were applied to the service portion of premiums.

84. Quite a different set of considerations applies with respect to the tax under The Fire Marshals Act. In Ontario, as elsewhere, the specific tax on fire insurance premiums is defended as a means of financing the costs of operation of a provincial service devoted to preventing and investigating fire. But to justify a levy by identifying the services financed by the levy, it is necessary to demonstrate that the services benefit those who pay rather than those who do not. At least two categories of people benefit substantially from the work of the Fire Marshals Office although they are not subject to the tax. These are owners of property who do not

carry fire insurance, and members of the general public whose personal safety is enhanced by fire prevention and protection. Further, we doubt that the burden of the tax is distributed fairly among those who are subject to it. Because fire insurance rates are in part a function of the availability and quality of municipal fire protection, persons in rural areas or otherwise poorly served in this regard must pay higher premiums. As a result these property owners will bear a disproportionately large share of the burden of the tax. We conclude, therefore, that the tax on fire insurance premiums is both unfair and unjustifiable. It arbitrarily forces a few people to pay for a service that might better be financed from general revenues. Accordingly, *we recommend that:*

> ***The tax on fire insurance premiums imposed under The Fire Marshals Act be abolished.*** **31:5**

Chapter 32

Revenue from Mines

INTRODUCTION

1. In this chapter we examine the Province's revenue from mineral production other than oil and natural gas. Ontario derives revenues under The Mining Tax Act, The Mining Act and The Beach Protection Act from the production of metals, industrial minerals and structural materials. The Mining Tax Act imposes a profits tax on mines. The Mining Act levies an acreage tax on mining lands, requires holders of mining leases to pay annual rentals and a royalty for certain kinds of mineral production, and imposes on the operators of quarries on Crown lands a charge for the material they remove. Finally, The Beach Protection Act requires licensees under that Act to pay a fixed sum per yard of material removed from lakes, streams and beaches. The revenues from mining leases and quarry operations and from sand and other materials removed by persons licensed under The Beach Protection Act are relatively insignificant; because we have no suggestions to make respecting these levies, we say nothing further about them.

THE MINING TAX ACT

HISTORICAL BACKGROUND[1]

2. Mining in the territory that is now Ontario first became subject to tax before Confederation when the Province of Canada levied a 2½ per cent royalty

[1]Principal source—T. W. Gibson, *The Mining Laws of Ontario and the Department of Mines*, Toronto: King's Printer, 1933.

on the value of ores raised or mined. This royalty, as subsequently modified in minor ways, remained in force until 1869 when it was repealed by The General Mining Act. No mineral taxes or royalties were imposed in Ontario from then until 1891 when the Sudbury area was beginning to be developed. The Mining Act of 1891 restored a royalty impost, but as that Act granted a seven-year exemption and was repealed in 1900, it had little effect. It was not until seven years later again that mineral taxation became a permanent feature of the Province's revenue system.

3. The Supplementary Revenue Act of 1907 introduced a tax on mining profits, which, after certain minor amendments[2] enacted in 1908, was embodied in a separate Act entitled The Mining Tax Act[3] of 1914. T. W. Gibson, who at this time held a position equivalent to Deputy Minister of Mines, explained the concept of relating the tax to mining profits in the following words:

> An impost on mine products, say so much per ounce of gold or silver, or per ton on nickel-copper ore, would not discriminate between rich ores and poor. An ounce of gold wrung with difficulty from low-grade ore would pay as much as an ounce taken from the richest quartz, so also a ton of ore just above the neutral point would be taxed as heavily as ore of the highest possible grade.
>
> The conditions indicated a tax on profits. It was considered right to claim for the public interest some share in the bounty of nature, especially when lands sold for $2.00, $2.50, or $3.50 per acre were found to contain great riches, sometimes a veritable Golconda.

4. From its introduction, the profits tax was levied upon profits derived only from the extraction of ore. In computing the taxable profit, only those expenses that directly pertained to the extraction of the ore and moving it to the surface of the mine were allowed as deductions from the value of the ore at the pit's mouth. This concept has been retained to the present day, although there has been some liberalization in expense deductions. The original Act made no allowances for either depreciation or the costs of discovery and development. This was defended as being reasonable in view of the low (3 per cent) rate of the initial tax. Municipal taxes were allowed as a deduction, contrary to the general principle of allowing only direct costs of mining. As an incentive to small mines, the first $10,000 of profits was exempted from tax. The 1907 Act was more concerned with simplicity of administration than with attaining scrupulously equitable treatment of taxpayers.[4]

5. From time to time since 1907 the rates of tax have been increased, and eventually a deduction for depreciation was allowed in the computation of mine profits. Very few other changes of substance have been made with the result that the statute now in effect is surprisingly similar to the original legislation.

6. Originally Ontario reserved the mineral rights whenever it made grants of land. This practice was discontinued in 1908, and all reservations previously

[2]S. O. 1908, c. 15.

[3]R. S. O. 1914, c. 26; now R. S. O. 1960, c. 242.

[4]See comments of G. R. Mickle, the first Mine Assessor, in *Proceedings of Twentieth National Conference of the National Tax Association, 1927*, at p. 349.

made were rescinded by a declaration from the Province that the mineral rights had "passed with the said lands to the subsequent and private owners thereof".[5] This sequence of events has had a significant effect on the form of mineral impost available to the Province: it is well established that a province is constitutionally unable to impose a royalty on mineral production from privately owned land as such a royalty is construed to be an indirect tax. In 1928, the Judicial Committee of the Privy Council[6] held that a percentage tax on the gross revenue from the sale of coal by a mine was an indirect tax which is *ultra vires* the enacting province. The Committee observed that there was "no doubt that the general tendency of a tax upon the sums received from the sale of the commodity which they produce and in which they deal is that they would seek to recover it in the price charged to a purchaser. Under particular circumstances the recovery of the tax may, it is true, be economically undesirable or practically impossible, but the general tendency of the tax remains." Despite the doubts one may have about the validity of this decision in today's metal markets, it has apparently never been challenged and, in the main, care has been taken by the provinces in their mining tax legislation to impose taxes that are without question direct. Ontario has avoided this problem by continuing to obtain its revenue from mining by a tax on profits which, as an income tax, is clearly in law a direct tax on the operator, even though it is in some circumstances shifted to the purchaser just as surely as a royalty.

7. The revenue from mining tax ranged from 1.0 per cent to 2.3 per cent of the Province's net ordinary revenue during the seven fiscal years 1960 to 1966, according to the following data obtained from the Public Accounts of Ontario:

Fiscal year ending March 31	*Mining tax revenue*	*Percentage of net ordinary revenue*
	(thousands of dollars)	%
1960	12,909	1.8
1961	17,097	2.3
1962	15,444	1.9
1963	15,222	1.5
1964	10,362	1.0
1965	14,387	1.2
1966	14,889	1.0

The relatively high revenue in 1961 was due largely to the high output of uranium producers in that year. While the mining tax makes only a minor contribution to Ontario's revenues, the annual amount is nevertheless significant.

THE PRESENT REVENUE STRUCTURE

Taxable Mines

8. The mining tax applies to profits derived from all mines and mineral workings from which metalliferous ore or other solid mineral substance is taken except

[5] Act to Amend The Public Lands Act, S. O. 1908, c. 16.
[6] *The King v. Caledonian Collieries, Limited* [1928] A. C. 358.

"diatomaceous earth, limestone, marl, peat, clay, building stone or stone for ornamental or decorative purposes, or non-auriferous sand or gravel". While the tax principally affects hard-rock mining, it also applies to the mining of asbestos, gypsum, nepheline syenite and rock salt.

The Tax Base

9. The tax is computed by applying graduated rates of tax to the "profit" of a mine determined by deducting specified mining expenses from the gross revenue from production. For this purpose, the Mine Assessor considers that the mine operation ends when the ore has passed through the primary crusher, and has so ruled even when the primary crusher is located underground.

10. When ore is shipped from the mine site without being processed, the gross revenue is the amount received from the sale of the ore. When the ore is treated at the mine, however, this simple measurement is not available and the gross revenue is then considered to be the "amount of the actual market value of the output at the pit's mouth" or, if this cannot be ascertained, the amount at which the Mine Assessor appraises the output.

11. When an appraisal is made, the Mine Assessor usually, but not invariably, follows a standard procedure. This consists of deducting from the sale price of the processed product the costs of processing and marketing, the portion of head office expenses allocable to processing, an allowance for depreciation of the processing plant and an allowance for a processing profit. The latter "processing allowance" is generally determined by the Mine Assessor at 8 per cent of the original cost to the operator of the assets used for processing, regardless of any depreciation that may have been claimed in respect of them, but this is modified inasmuch as he will not permit the allowance to be less than 15 per cent or more than 65 per cent of the profits of the combined mining and processing operations before deducting the allowance itself. These lower and upper limits for the allowance are arbitrary devices which were adopted to ensure that not more than 65 per cent of the profits of the combined operations of marginal producers would be attributed to processing and that, where the investment in processing assets was small relative to that in other assets, the allowance would not fall below 15 per cent of such profits. In practice the mine assessor gives the operators of nickel mines a special processing allowance in addition to the general allowances described above in recognition of what he considers to be special conditions that apply to the smelting and refining of nickel ores. From 1939 to 1955, but not subsequently, the basis of the special allowance was authorized by order-in-council. To summarize, under this method of appraisal the value of ore at the pit's mouth is determined by deducting from the value of the processed product specified processing costs and an allowance for processing profit.

12. The authority given to the Mine Assessor to appraise the output is such that an appraisal made by him cannot be upset unless it can be shown to be so unreasonable as to throw doubt on whether he has actually carried out the duty placed on him. The effect is that if the Mine Assessor has made a conscientious effort to carry out an appraisal, the courts will uphold his appraisal.

13. From the gross revenue determined in one of the three ways described above, The Mining Tax Act permits the deduction of certain specified expenses, including:

(a) the costs of transporting the ore,

(b) the "proper working expenses" of the mine, both surface and underground, including office expenses directly connected with the mining operations,

(c) depreciation on mining plant of not less than 5 per cent and not more than 15 per cent per annum calculated on a straight-line basis,[7] and

(d) at least 15 per cent of the cost of exploration and development carried out anywhere in Ontario following the commencement of production, which has as its object the discovery or development of new ore bodies, but excluding expenses incurred in the acquisition of an interest in or an option to buy or mine any ore body which may be discovered.

Three points are worthy of note with respect to the allowable expenses outlined above. First, the Mine Assessor has developed a list of expenses which are not regarded as proper working expenses of the mine: this is reproduced in Table 32:1. Second, the expenses of a gold mine that are allowable as deductions must be reduced pro rata by amounts of assistance received under the federal Emergency Gold Mining Assistance Act. Third, the right to claim a deduction of as little as 15 per cent of outside exploration expenditures and to defer the balance until subsequent years is often used by mining companies to regulate the amounts of mining taxes they pay.

14. By reducing the expenses of a gold mine pro rata for amounts of assistance or cost-aid provided under the federal Emergency Gold Mining Assistance Act, Ontario in effect taxes the assistance payments. Furthermore, there are a great many cases where the cost-aid exceeds the taxable profit of the mine; here Ontario taxes nothing but the Emergency Gold Mining Assistance payments. This is apparent from Table 32:2, which shows that in the years indicated the Emergency Gold Mining Assistance payments included in computing taxable profits substantially exceed the taxable profits of gold mines.

15. No deduction from gross revenues is allowed for depletion of the mine, royalties other than those payable to the Crown or dividends or interest paid upon the share capital or debt of the mining company. The statute also prohibits any deduction for the "cost of development of the mine liable for taxation under this Act before the commencement of output therefrom". However, another provision of the Act requires an annual deduction following commencement of production of at least 15 per cent of the cost of actual exploration and development work done in Ontario with the object of finding, testing or opening up ore bodies. The effect of these two provisions taken together is that all of the exploration and development

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[7]An allowance for depreciation of a processing plant is also permitted by the Mine Assessor when appraising the "actual market value of the output at the pit's mouth". In practice, he allows at least 5 per cent and usually not more than 15 per cent of cost, although he has allowed as much as 25 per cent.

TABLE 32:1

EXPENSES NOT REGARDED BY THE ONTARIO MINE ASSESSOR AS "PROPER WORKING EXPENSES OF THE MINE"

1. Cost of annual meetings and of distribution of notices and reports to shareholders. (Cost of printing the reports is allowed.)
2. Advertising other than for promotion of sales and recruitment of employees.
3. Bank charges for storage of securities.
4. Fifty per cent of directors' fees and expenses.
5. Legal fees not directly connected with the operation of the mine or mill.
6. Stock exchange fees.
7. Transfer and registration fees.
8. Cost of acquiring land including legal fees, purchase price, option payments, rent, miner's licence fee, recording fees and royalties other than to the Crown.
9. Taxes of all kinds—municipal, provincial and federal (except sales and excise taxes on purchases of goods and equipment).
10. Insurance premiums attributable to loss of profit portion of use and occupancy insurance.
11. Management fees to the extent deemed by the Assessor to be not referable directly to mining or processing or to be a profit to the management company.
12. Membership fees such as for chambers of commerce, boards of trade and service clubs.
13. Subscriptions to publications other than those directly concerned with mining or metallurgy and the metal markets.
14. Donations other than those for charitable purposes in Ontario or for educational or patriotic purposes in Canada.
15. Salaries and other expenses deemed by the Mine Assessor to be not directly connected with mining or processing.

expenses incurred by a mine operator prior to the time that his first Ontario mine comes into production are lost forever as a deduction, whereas such expenditures incurred after that time, at the producing mine or at any other place in Ontario, are fully deductible in the year incurred or in subsequent years.

Computation of the Tax

16. The first $10,000 of mining profits, as determined under the Act, is exempt from tax. Profits from $10,000 to $1 million are taxed at 6 per cent, from $1 million to $5 million at 11 per cent, and above $5 million at 12 per cent. The Act requires that all mines worked or operated by the same person or under the same general management or control be treated as one mine. In practice, the profits of separate mines are combined only if they are owned by the same corporation, and where one mining company controls another by holding its shares, the two companies are treated as separate taxpayers. The aggregate amount of tax collected, classified by brackets of taxable profits, is set out in Table 32:3 for the 1959 to 1963 taxation years of the mines.

17. The Act provides that the Minister of Mines "may" remit the tax on profits from mining iron ore that is smelted in a Canadian steel mill. In practice, the remission is always made. The amount of tax remitted is the same proportion of total mining tax otherwise payable that shipments of ore from the mine to Canadian steel mills are of total shipments of ore.

18. The Act also allows any tax on the profits of a mine payable under The Assessment Act to a municipality or to a school board in unorganized territory to

TABLE 32:2

EFFECT OF FEDERAL EMERGENCY GOLD MINING ASSISTANCE UPON ONTARIO MINING TAX AND TAXABLE PROFITS OF GOLD MINES

	1962		1963		1964	
	Number of mines	*Thousands of dollars*	*Number of mines*	*Thousands of dollars*	*Number of mines*	*Thousands of dollars*
*Net Taxable Profits:**						
All gold mines..........	28	$13,681	29	$14,539	29	$11,419
Mines not receiving E.G.M.A.............	5	9,618	5	5,306	4	3,168
Mines receiving E.G.M.A.	23	4,063	24	9,233	25	8,251
E.G.M.A. received......		9,574		10,047		10,248
Net loss if E.G.M.A. excluded †...........		$ 5,511		$ 814		$ 1,997
Mining Tax:						
Mining tax paid by gold mines receiving E.G.M.A.		$ 248		$ 705		$ 632
Reduction if E.G.M.A. had been excluded... .		238		316		358
Tax payable if E.G.M.A. had been excluded .		$ 10		$ 389		$ 274

Source: Figures prepared by Ontario Mine Assessor's Branch.

*"Net taxable profits" means the taxable profits of profitable mines less losses of unprofitable mines.

†"Net loss if E.G.M.A. excluded" means the losses of unprofitable mines less the taxable profits of profitable mines, after excluding E.G.M.A. from income.

be deducted from the mining tax payable to the Province. This has the same effect as exempting the mines from local profits taxes. However, under present policy, municipalities are not usually permitted by the Department of Municipal Affairs to levy taxes on the profits of a mine; instead a mining municipality may apply for a payment from the Province. School boards in unorganized territories, however, do impose the profits tax under The Assessment Act.

Administration and Appeals

19. Each mine is required to pay an estimate of its tax by the end of the second month following the close of its fiscal year, failing which the tax is increased by 10 per cent on the day it became due and by a further 10 per cent on each anniversary of that day on which the tax remains unpaid. In addition, interest is payable at 6 per cent per annum on any deficiency until paid. A mine is required to file a return containing an estimate of the tax due and such information as is required by the Mine Assessor within six months of the close of its fiscal year. From the returns filed by the mines, the Mine Assessor prepares a tax roll, which sets out under various headings the information received and the amount of the tax liability of each taxpayer. The Mine Assessor must send the taxpayer a notice of assessment confirming or altering the taxpayer's estimate. If he assesses the liability at a greater amount than the taxpayer's estimate, the taxpayer may appeal the assessment. If the Assessor assesses the liability at a lesser amount, he is required to make an immediate refund.

TABLE 32:3

ONTARIO MINING TAXES PAID CLASSIFIED BY PROFITS BRACKETS
1959-1963

	6% Tax Bracket	*11% Tax Bracket*	*12% Tax Bracket*	
	$10,000 to $1,000,000	*$1,000,000 to $5,000,000*	*Over $5,000,000*	*Total*
Number of mines paying tax in each bracket				
1959	45	16	6	45
1960	52	24	12	52
1961	52	13	6	52
1962	42	14	6	42
1963	45	12	4	45
Taxable income in each bracket (thousands of dollars)				
1959	23,000	41,000	72,000	136,000
1960	30,000	41,000	100,000	171,000
1961	23,000	30,000	93,000	146,000
1962	24,000	37,000	59,000	120,000
1963	25,000	25,000	49,000	99,000
Taxes paid in each bracket (thousands of dollars)				
1959	1,400	4,500	8,600	14,500
1960	1,800	4,500	12,200	18,500
1961	1,400	3,300	11,100	15,800
1962	1,400	4,100	7,100	12,600
1963	1,500	2,700	5,900	10,100

Source: Information prepared by Ontario Mine Assessor's Branch.

Notes: 1. The above figures are for the taxation years of the mines ended in the calendar years indicated. They are not to be confused with amounts collected by the Province in its fiscal years ended in the same calendar years, which appear in other tables. As all assessments are not finalized for some years, more recent figures were not available.

2. Money figures are rounded.

20. To institute an appeal the taxpayer must file a written notice with the Department of Mines within fifteen days of the mailing of the Mine Assessor's assessment, stating the grounds of objection. The Minister of Mines may refer the appeal either to the Mining Commissioner or to the Ontario Municipal Board as he sees fit, although to date only three appeals have been referred to the Mining Commissioner and two to the Board. An appeal from a decision of either of these bodies may be taken to the Court of Appeal by filing a notice of appeal with the Department of Mines within fifteen days of the decision.

21. The Mine Assessor's Branch consists of the Mine Assessor, one assistant assessor and one clerk. The Province's costs of administration of this branch could hardly be less. That it is possible to administer the Act with such a small staff is due partly to the modest number of returns to be processed and partly to the

assistance given by mine operators in providing the detailed information required by the returns. The typical return under the Act is a bulky set of documents.

22. Despite the costs of compliance, it appears that taxpayers seldom raise complaints about the amount of work the returns demand. The provision of this detailed information has become part of the accounting routine of corporations and the cost is absorbed as part of the administrative overhead. Thus, although the administration of the Act is economical for the Province, a substantial share of the cost of assessment is carried by the taxpayer himself.

REVENUE STRUCTURE IN OTHER PROVINCES

23. Every province except Prince Edward Island obtains revenue from taxes or other charges specifically levied on mines and mineral production. The comments that follow set out the main structural differences among the mining taxes of the various provinces.

Type of Tax

24. All provinces, with the exception of Prince Edward Island and Alberta, impose taxes upon profits derived from mining operations and, some of them, from processing the ore mined. By contrast, Alberta imposes a pure royalty on mineral production from lands held under lease or certificate of record. In addition to the profits tax or royalty, each of the prairie provinces levies a tax of 0.8 per cent of the assessed value of minerals contained in mineral lands in designated producing areas, and Newfoundland imposes a tax not exceeding 1.0 per cent on the assessed value of hematite contained in mineral lands.

The Tax Base

25. With the enactment of Quebec's Mining Duties Act, which became effective in 1966, all the provinces that impose a profits tax now seek to tax only the profit derived from the mining of minerals. They have either devised methods of eliminating revenues derived from processing operations or have established a system of appraising the value of ore at the pit's mouth before it is processed. Before 1966, Quebec's mining tax applied to the combined profits of the mining and processing operations.

26. In British Columbia, New Brunswick and Quebec, the processing allowance is almost identical with that of Ontario, being 8 per cent of the original cost of the processing assets, but not more than 65 per cent or less than 15 per cent of net mining profits after all other deductions. The allowance in Newfoundland is similar in that it has an upper limit of 65 per cent of the net mining profits, but there is no lower limit. Saskatchewan and Manitoba allowances are also similar but the lower limit depends upon the kind of metal being refined and upon the proportion that the value of a particular metal recovered is to the total value of all metals recovered. In every province except Ontario the method of valuation is published either in the taxing statute or in regulations.

27. All the provinces imposing a profits tax include in income, payments received under the federal Emergency Gold Mining Assistance Act. In some of the

TABLE 32:4

PROVINCIAL* MINING PROFITS TAXES AND ROYALTIES IN CANADA: SUMMARY OF EXEMPTIONS, RATES AND PRINCIPAL DEDUCTIONS

		British Columbia	*Saskatchewan*†	*Manitoba*	*Ontario*	*Quebec*	*New Brunswick*	*Nova Scotia*‡	*Newfoundland* *Iron Mines*	*Newfoundland* *Other Mines*
Basic Exemption		$25,000	$25,000	Nil	$10,000	$50,000	$10,000	$10,000	Nil§	Nil§
Rates Levied on Portion of Profits										
Over	*But Not Over*									
Exempt Amt.	$ 100,000	10%	5%	6%	6%	9%	7%	3%	20%	5%
$ 100,000	500,000		7%							
500,000	1,000,000		9%							
1,000,000	2,000,000			9%	11%	11%	8%	5%		
2,000,000	4,000,000					13%				
4,000,000	5,000,000					15%				
5,000,000	10,000,000			11%	12%		9%	6%		
10,000,000								7%**		
Relief for New Mines		3-year exemption	3-year exemption to maximum of $2,000,000	50% reduction for 3 years	None	None	None	None	None	
Deductions from Profits										
Interest		Yes	No	No	No	No	No	No	No	
Pre-production costs		Yes	5-15%††	10%	No	15%§§	15%	Yes	Yes	
Corporate expenses		Yes	Yes	No	No	No	No	No	No	
Municipal taxes		Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	
Bad debts		Yes	No	No	No	No	No	No	Yes	
Loss carry over		No	No	No	No	No	No	No	No	
Depreciation allowance		Amt. booked if reasonable	5-15%††	0-30%‡‡	5-15%††	0-15%	0-15%	0-15%	10%	

*Alberta collects royalties on gross revenues, and does not impose a tax or royalty based on profits.

†Applicable to "new mines", i.e., a mine deemed by Minister of Natural Resources to be a new mine commencing operations after December 24, 1964; profits tax on old mines—12½%.

‡Profits tax applicable only if substituted by Minister of Mines for royalties on production otherwise payable; profits tax on gypsum mines earning more than $5,000 is 33⅓%.

§No tax payable where gross income is less than $5,000; 20% tax on iron ore profits not to exceed 10¢ a ton on first 1,500,000 tons and 8¢ on each additional ton.

**Rate is 6%+1% for each $5,000,000 in excess of $10,000,000.

††Mandatory annual allowance of 5%; permissive to 15% per annum.

‡‡Depreciation allowance in excess of 10% requires approval of Lieutenant Governor in Council.

§§Mandatory allowance of 15% per annum.

provinces the payments are included directly in income; in others the allowable expenses are reduced pro rata by amounts equal to the payments.

28. A deduction for depreciation of mining and processing assets is allowed by all provinces taxing mine profits. In New Brunswick the amount subject to depreciation includes pre-production expenses. The statutes of Manitoba, Quebec, Nova Scotia and New Brunswick specify maximum rates: 10 per cent in Manitoba and 15 per cent in the other three provinces. In Ontario and Saskatchewan the statute or the regulations limit depreciation of mining assets to a 15 per cent maximum and a 5 per cent minimum, but depreciation allowed by Ontario for processing assets (in practice at least 5 per cent and usually not more than 15 per cent but sometimes as high as 25 per cent) is discretionary with the Mine Assessor. In Newfoundland, where the rate of depreciation is discretionary, the Minister has by gazetted order allowed 10 per cent. In Manitoba the Lieutenant Governor in Council may authorize a rate in excess of the statutory rate of 10 per cent but not in excess of 30 per cent. In British Columbia the amount of depreciation provided in the books of account of the taxpayer will ordinarily be allowed.

29. While none of the provinces except Ontario has a statutory prohibition against deducting exploration and development expenses incurred prior to production, only British Columbia, New Brunswick and Quebec specifically authorize a deduction by statute. In the remaining provinces the amounts of pre-production expenses that may be deducted are discretionary. As explained earlier, Ontario's prohibition applies only where the mine operator does not already have a producing mine in Ontario from which he can deduct the expenses of exploration and development carried on either at that mine or elsewhere in the province.

30. Royalties paid to owners of mining land, other than the Crown, are not usually deductible in calculating mining profits. They appear to be deductible in British Columbia and Manitoba where they are not included among the prohibited deductions. In Ontario, New Brunswick and Newfoundland the deduction of royalties is disallowed by statutory provisions. In other provinces the allowance of royalties as a deduction is discretionary.

31. While British Columbia alone allows a deduction for interest on borrowed funds in computing mining profits, Ontario, New Brunswick and Newfoundland are the only provinces that specifically disallow a deduction in their taxing acts. In the remaining provinces the deduction is prohibited by regulation or is disallowed in practice.

Rates of Tax and Basic Exemption

32. The rates of tax and the annual exemptions vary considerably, as will be seen from a review of Table 32:4. The exemptions range from zero in Manitoba to $50,000 in Quebec. The rates vary from 3 per cent on the portion of profits not exceeding $1 million in Nova Scotia to 15 per cent on the portion of profits over $4 million in Quebec. British Columbia and Newfoundland have single rate structures except that in Newfoundland the rate differs for iron mines. Nova Scotia has a single rate structure for gypsum mines. Other provinces imposing a profits

tax have a three-stage rate structure except Nova Scotia and Quebec. In Nova Scotia, for profits up to $10 million from mining minerals other than gypsum, there is a three-stage structure, with a further step-up in rate for each additional $5 million of profits in excess of $10 million. There the graduated profits tax is applicable only if substituted, at the discretion of the Minister of Mines, for royalty payments based on production that would otherwise be payable. Quebec has a four-stage rate structure.

33. In comparing Ontario's rates with those of the other provinces, it is necessary to take into account that about one-third of Ontario's revenue from the tax is paid to mining municipalities in lieu of assessments of mines by municipalities and school boards in respect of properties employed in mining, and that no other province has a similar arrangement. The part of the tax retained by the Province for the use of the resources is therefore equivalent to 4 per cent of profits over $10,000 to $1 million, 7⅓ per cent of profits over $1 million, up to $5 million, and 8 per cent over $5 million. Thus, the level of mining taxation in Ontario, after deducting the portion paid to mining muncipalities, is much lower than in all but one of the other provinces with significant amounts of metal production, namely Quebec, British Columbia and Manitoba. It is difficult to make a comparison with Newfoundland because the tax at the 20 per cent rate applicable to iron mines is subject to a maximum based on a rate per ton of ore produced. The value of metal production in all provinces for the year 1966 is set out in Table 32:5.

JUSTIFICATION

34. A special tax on mines can be justified on the same grounds as oil royalties or timber dues, namely, as a means of securing for the Province a share of the economic rent for the use of its resources. For administrative and con-

TABLE 32:5

VALUE OF MINERAL PRODUCTION IN CANADA FOR 1966
OTHER THAN FUELS AND STRUCTURAL MATERIALS

	Metals	*Non-metals*	*Total*
	(millions of dollars)		
Ontario	747	23	770
Quebec	457	175	632
Newfoundland	223	14	237
British Columbia	190	23	213
Manitoba	142	3	145
Northwest Territories	112	—	112
New Brunswick	69	2	71
Saskatchewan	43	84	127
Yukon	11	—	11
Nova Scotia	2	15	17
Alberta	—	35	35
Total	1,995	374	2,369

Source: Preliminary estimate by Dominion Bureau of Statistics, January 1967.
Note: Totals do not add because figures taken to nearest $1 million.

stitutional reasons which we discuss in the course of this chapter, the imposition of a royalty or gross income tax on the output of Ontario mines is impracticable. A profits tax is the logical alternative. It is also better suited to an industry that is characterized by a high degree of risk because a profits tax does not penalize the person who makes a wrong decision about committing resources to a particular mining operation.

35. We may observe at the outset that having sold to private persons the title in fee simple to most of its mining lands, the Province appears to have narrowed considerably the range of alternatives constitutionally available to it for exacting rent for the use of such resources. Until fairly recently, the outright ownership of Crown land that might contain minerals could be acquired upon payment of a nominal sum, and substantial tracts of mining lands have passed into private hands. Now, lacking the rights of ownership, the Province encounters more difficulty in imposing charges that provide an appropriate return to the public treasury from the private exploitation and development of these mining lands. On the other hand, it can be said that the Province parted with ownership of mining lands for a nominal price in the knowledge that it was at the time imposing and would continue to impose a profits tax, which is more likely to be related to the value of the lands than is any royalty, based on price or production, determined in advance of the development of a mine. We hasten to point out, however, that a mining profits tax, at the rates now imposed in Ontario, fails to produce an appropriate amount of revenue, the criteria for which we develop later.

36. The present form of the tax is substantially the same as when it was first introduced, which probably indicates that pressures for change have not been great. This may be due partly to the relatively low rates of tax and partly to the fair manner in which the Act is administered. We have heard no criticisms directed at the administration of the Act. There are a number of weaknesses in the tax structure, however, that merit attention.

37. One fundamental criticism is that the nature of the tax is by no means clear. It is neither a tax on actual profits, because of the severe limitation on deductions, nor a royalty. The present position seems to have been reached by a process of arbitrary decision-making rather than as a logical result of basic principles. The quotation from Mr. Gibson in paragraph 3 indicates that the original intention was to tax profits because a royalty was thought to be incapable of providing equity. The Act of 1907 was drawn accordingly, but various elements normally entering into the calculation of profit were omitted, the most important being depreciation of capital assets, and costs of discovery and development. These omissions were originally tolerable, if Mr. Gibson's account is true, because the rate of tax was low (3 per cent), but such toleration has no logic. In time, a reasonable allowance for depreciation was introduced, but no allowance has ever been permitted for pre-production expenses, except as a deduction from profit of another mine of the operator.[8]

[8]See paragraph 15.

38. The mining tax is to be distinguished from a royalty reserved by the Crown not as a taxing authority but under a lease granted by the Province as owner of the land or minerals. Thus, the oil and gas royalties reserved by Ontario when leasing off-shore properties in the lower Great Lakes are not invalidated by the *Caledonian Collieries* case referred to in paragraph 6.

39. In order to impose a constitutionally valid royalty on mineral production, the whole basis of land tenure for mining companies in Ontario would have to be changed. Such a change after almost sixty years would be most difficult, and would amount to the most extensive and the most expensive expropriation in the history of the province. As we have said earlier, we think that a profits tax is probably better suited than a royalty to obtain revenue from a high-risk industry, inasmuch as, unlike a royalty, it does not tend to convert a marginally successful mine into a loser. We therefore conclude that, for constitutional and economic reasons we should accept the concept of a profits tax rather than a royalty for the taxation of mines.

40. It should be borne in mind that the justification for any form of special or additional taxes on mineral resources must lie in its ability to appropriate for the Province some part of the economic rent accruing to the private owners of such resources. By "economic rent" we mean simply the amount by which, on the average, the return on capital invested in mineral development *exceeds* the return where capital is employed in the best alternative areas of investment. In practice these rates of return are difficult to calculate with precision, but in theory, if it wished to do so, the Province might tax away the full amount of such economic rent without adverse effect upon the allocation of resources to mining. We think, however, that in a high-risk industry, it is both impracticable and imprudent for the Province to attempt to recover the full economic rent accruing from the use of mineral resources, and our subsequent proposals as to reasonable levels of taxation have been developed, in part, in relation to the current taxation of such resources by other Canadian provinces.

41. We should not lose sight of the fact that Ontario's mining tax, in addition to obtaining a measure of return to the Province from its resources, performs the function of extracting from profitable mines the revenue needed by the Province to make payments to mining municipalities. These payments are in effect compensation to the mining municipalities and school boards for being deprived of any opportunity to levy property and business taxes on mine buildings, plants and machinery, and the minerals in or on the land. Thus, part of the provincial mining tax levy contributes to the provision of municipal services to mines, but not on the basis of benefits received. Profitable mines are required to pay for the municipal services rendered both to them and to the unprofitable mines that go free of tax.

42. The amount of the payments to mining municipalities is determined by a complex formula, one important element of which is the profits of the mines located within each municipality. This formula has evolved from a former system under which mining municipalities levied fixed rates of tax on that amount of profit

which was also subject to the provincial mining tax. The municipal profits tax was then allowed to the mines as a deduction from the provincial mining tax.

43. The principle of the present scheme has met with favour from both the municipalities and the mines. We discuss the present basis for making such payments to mining municipalities in an earlier chapter where we propose certain modifications of the system. Although we are cognizant of the limitations of the principle of ability to pay in equitably financing many local services, we are not prepared to recommend any different method of financing the mines' share of the cost of municipal services. A full discussion of these payments is included in Chapter 12.

44. The mining tax that we propose later must therefore also provide the funds needed to finance payments to mining municipalities for the share of the cost of municipal services allocable to mines. In our view, however, all profitable mines should contribute to this purpose, not only those that earn a greater return on their invested capital than is obtained in other industries.

INCIDENCE

45. The incidence of the mining profits tax is broadly similar to that of the corporation income tax, with the degree of shifting affected by the market conditions relating to the principal product of the mine. For a gold mine, where the price received from the mint is fixed, it would at first appear that shifting is not possible. However, gold mines whose costs, including the Ontario mining profits tax, lie between \$26.50 and \$45 per ounce and that receive Emergency Gold Mining Assistance, succeed in shifting four-ninths of the tax to their customer, the Government of Canada.[9]

TABLE 32:6

ONTARIO MINING TAX
ASSESSED FOR YEARS 1962 TO 1964
EXPRESSED AS A PERCENTAGE OF VALUE OF METAL PRODUCTION
CLASSIFIED BY PRINCIPAL METAL PRODUCTS OF EACH MINE

*Mine Metal Group**	*1962*	*1963*	*1964*
Gold	1.27%	1.26%	1.21%
Silver	.86	1.56	1.49
Iron ore	1.77	1.66	1.55
Nickel	1.65	1.59	2.21
Uranium	3.17	1.72	.53
Copper	1.81	2.06	2.68
Other	1.10	1.01	1.35
All mines combined	1.86	1.58	1.89

Source: The Mine Assessor from an analysis of mining tax returns.
*In the compilation, all of each taxpayer's production and tax is included in the metal groups for the taxpayer's principal metal product.

[9]The assistance is paid, on two-thirds of the ounces of gold produced, at an amount per ounce equal to two-thirds of the excess over \$26.50 of the cost per ounce, up to a maximum cost per ounce of \$45.00.

46. For producers of copper, lead and zinc, for whom competitive market conditions exist, there can be no short-run shifting. Any longer-term effect will be reflected in the volume of investment in mining in Ontario. As can be deduced from Table 32:6, the present tax is so small that any possible effect it might exert upon the volume of investment in copper mining in Ontario would be so small as to have no discernible effect upon the world price of copper, and in our view an increase in the weight of the tax, such as contemplated by us, would have no measurable effect on exploration, particularly if the tax is structured as we suggest later so as to apply to the portion of profits in excess of a reasonable return. The effect upon prospective profits would then have no inhibiting effect as it would apply only if the venture were highly profitable. The increase in the weight of the tax from 1962 to 1964—1.81 per cent to 2.68 per cent of the value of production —reflects the effect on profits of increased world prices brought about by changes in supply and demand; there was no increase in the rates of tax.

47. With few exceptions, Ontario iron mines are operated either by Ontario steel corporations or companies affiliated with United States steel manufacturers. The major amount of Ontario's iron ore production is thus used for steel-making by the mine operator, the United States parent or some other affiliate of the mine operator, and so the burden of the mining profits tax falls at least initially upon the steel manufacturer either directly as the mine operator or indirectly as the shareholder of the mine operator. Because of the competitive conditions existing in the steel industry there can be no shifting in the short run, and since the proportion of the total requirements of U.S. mills filled from Ontario ore is so small it is doubtful that the tax would have any significant effect upon the price of steel in the United States, even in the long run. In the event that owners of iron ore deposits sell or lease their mining lands to U.S. steel manufacturers or their Canadian subsidiary companies, theoretically at least the tax burden would primarily rest on the lessor to the extent that the over-all costs of production, including lease royalties, interest on investment and tax, would otherwise exceed the current and prospective price for iron ore. However, the level of the present tax is so low—1.55 per cent of the value of production for 1964—that we conclude that, as is true of other metals, it could easily be increased without any deleterious effect on iron ore exploration or investment.

48. The burden of the tax on uranium mines in the early stages of their history probably fell upon the mines as all of their production was sold under government contracts at prices based on cost plus a margin for profit, and for this purpose mining tax was probably not recognized as a cost. Subsequent contracts for stock-piling purposes have been negotiated at much reduced prices as capital costs had been largely recovered from the earlier contracts. The prime purpose of these contracts is to keep the mines in operation and so it is unlikely that any part of the mining tax is being shifted in the prices received. The future of the industry rests to a large extent on the development of the use of uranium for generating nuclear electric power, and in these circumstances the incidence of any mining tax on uranium would be determined by the operation of ordinary market forces. Expressed as a percentage of the sales value of uranium production, according to

Table 32:6, the mining tax ranged from 3.17 per cent in 1962 to .53 per cent in 1964. The decrease reflects the closing of some mines and a substantial reduction in the profitability of others consequent upon the expiry of the earlier contracts.

49. Ontario's uranium mines will become increasingly profitable as demand for nuclear electric power rises. Of the total cost of 3.5 to 4.0 mills per kw.h. of electricity generated by a natural uranium-fuelled Candu reactor, .2 mills would be attributable to the cost of uranium at $5 per pound (approximately the basic price received from stock-piling contracts); at $8 per pound, the uranium cost per kw.h. would be .32 mills. For electricity generated in a heavy-water reactor comparable figures would be .907 mills at $5 per pound and 1.03 mills at $8 per pound of uranium—a 60 per cent increase in the price of uranium resulting in an increase of only 14 per cent in the fuelling costs per kw.h. of electricity produced.[10] A mining tax equivalent to 3.17 per cent of the value of production, as it was for 1962, would, if shifted to the purchasers, represent from .006 mills to .033 mills, according to the type of nuclear reactor used and whether the price was $5 or $8 per pound. It is therefore clear that even if the present tax were largely shifted it would not have any significant effect on the cost of nuclear-generated power; nor would a tax of moderately larger dimensions.

50. This brings us to the nickel mines, where two large Ontario mining companies are the most significant suppliers in the world market and are consequently able to provide effective price leadership. They are subject to constraints from potential new competitors and from competing materials but this still leaves them with considerable room for independent action. We think, however, that any contemplated increase in the mining profits tax, which would apply only to profits in excess of a reasonable return, as we suggest later, would not be so significant as to induce the companies to change their prices; but if prices were increased, the shift in tax would be largely to foreign purchasers. As in the case of copper mining, we conclude that any effect of the present or prospective tax upon the volume of exploration for nickel deposits in Ontario would be too small to be measured.

A REVISED SYSTEM FOR TAXING MINING PROFITS

GENERAL OUTLINE

51. As stated earlier, we accept the concept of a profits tax for mining. We have indicated that in so far as the tax is a substitute for municipal and school board taxation, it should be based on total profits, and that to the extent that it represents Ontario's return from the exploitation of its resources, it should be based on that portion of the profits that is in excess of the normal return on investment in industry.

52. As a fairly simple way of achieving this result we propose a two-stage tax, as follows:

(a) a first-stage tax designated the Mines Services Tax, at a rate sufficient to yield the approximate amount needed to finance provincial payments to

[10] *Uranium: The Fuel Source of the Atomic Era,* Burns Bros. and Denton Limited, April 1966, p. 23.

mining municipalities, which would be levied on the profits from a mine derived from both mining and processing operations as defined later, and

(b) a second-stage tax, designated the Mines Profits Tax, at an appropriate rate for the use of Ontario's mining resources, which would be levied on the profits determined for the first-stage tax after deducting (i) the first-stage tax, (ii) Emergency Gold Mining Assistance, (iii) an allowance for exploration expenditures, and (iv) an investment allowance.

If at any time the Province makes other public service expenditures that reasonably should be financed by contributions from the mines, the Mines Services Tax could be extended to produce the necessary additional revenues.

53. For three reasons we propose that profits from both mining and processing operations be included in the base. First, the base we propose for the second-stage Mines Profits Tax would give effect to a comparatively generous investment allowance in respect of the company's gross investment in both mining and processing assets. In effect, this tax would therefore not apply to the profits represented by a normal return on either the processing or the mining assets. Second, we believe that all profits from the mine, whether mining or processing, should be subject to the first-stage Mines Services Tax, as this merely permits the mines to discharge their collective obligation to pay for municipal services. There seems to be no valid reason for exempting processing profits from this tax, particularly when processing plants generally are exempt from municipal taxation under The Assessment Act. Our third reason is that the present federal and provincial income tax concessions to mines (i.e., the new mines exemption and depletion allowances) extend to profits through the prime metal stage. We agree with this position; and if processing profits are considered to be profits from the operation of a mine for the purpose of income tax concessions, consistency requires that they should be similarly considered for the purpose of the mining tax.

54. Not all mines completely process their own ore, and the taxation of profits through the prime metal stage would result in complications in such cases. We suggest that when ore or concentrate is shipped for processing in Ontario to another Ontario mine operator, with whom the shipper is dealing at arm's length, the shipper be taxed on the profits realized by him and the processor be taxed on the processing profits as if they arose from processing his own mineral production. Inasmuch as this would obviate the necessity of prorating costs of processing in order to arrive at the portion applicable to the processor's own mineral production, this arrangement would be a simplification of present practice.

55. When ore or concentrate is shipped to a processor who is not engaged in mining in Ontario and with whom the shipper is dealing at arm's length, only the amounts actually realized by the shipper from the ore or concentrate would be included in the computation of the mining profits of the shipper; the processor would not be subject to the mining profits tax but he would be subject to municipal property tax. Where there is an arm's-length relationship, we believe that the profits of the processor would be reasonable and within range of a normal return on his investment.

56. In the event that the ore or concentrate is shipped to a processor who is not dealing with the shipper at arm's length, we would compute the shipper's profits either by combining the profits of the processor with those of the shipper as if they were one entity, or by valuing the shipper's ore or concentrate at fair market value.

57. Another complication arises from an integrated iron mine and steel mill. Here we suggest that the mining profit be computed to the same point in the operation as is now done in computing the profits reasonably attributable to the production of prime metal for income tax purposes. This would involve including in the base for the proposed investment allowance the portion of the plant used to that particular point of processing. Alternatively, the profits could be determined by including in the computation the fair market value of the pig iron produced from the raw, pelletized, sintered or otherwise beneficiated iron ore which is fed into the blast furnaces.

58. The Mines Services Tax should be imposed at a flat rate, for it replaces the municipal property tax, which is imposed at a flat rate on commercial and industrial properties, and the municipal business tax, which is imposed at a flat rate although on unequal assessments. We also propose a single rate for the Mines Profits Tax. The present rates of tax, graduated according to the amount of income and without relation to the size of investment required, are an inequitable exaction of Ontario's return for the use of the resource. Nor would it be equitable to apply graduated rates of tax to the profits remaining after deducting an investment allowance, as this would still not be relating the taxed amount of profits to the size of the mine operator's investment. We see no justification in requiring a mine operator, who has taxable second-stage profits of $5 million, to pay a rate of Mines Profits Tax on any part of his profits, which is higher than that paid by an operator with profits of $500,000, where for each the profits represent exactly 10 per cent of the investment. In our view, the amount of the tax should provide a fair return to the Province for the use of the resource, and the interests of the Province and equitable treatment of the operators would both be ensured by a flat-rate tax.

59. In a previous chapter we have explained that we received sympathetically but rejected submissions advocating that mining properties be subject to municipal taxation in the ordinary way, a policy which would of course involve the abolition of the payments from the provincial government to the mining municipalities. The conclusion we reached was that given the present municipal structure, the distribution of such revenue would not be appropriately related to the responsibilities of particular municipalities for providing services. Little or no revenue would go to the so-called "dormitory" municipalities, which provide services to the mine workers living therein, and more than enough revenue, considering the services required, would go to the neighbouring municipalities in which the mines happen to be located. We are hopeful that the time will come when Ontario's municipal structure will be reconciled with local finance as we have recommended in Chapter 23. If this happens it might be feasible for mining municipalities to tax mining

properties instead of relying upon provincial payments financed through the mining tax, although admittedly a number of difficult assessing problems would have to be overcome. In this event, it would be a simple matter to abolish the Mines Services Tax.

60. Ontario mining enterprises sometimes engage in activities other than mining and the production of prime metal, and some carry on mining operations both within and outside Ontario. An equitable basis for the exclusion of income from sources other than mining and the production of prime metal in Ontario should be an integral feature of any legislation stemming from our proposals.

61. Our studies indicate that under the system of mining taxation that we propose, a Mines Services Tax of 3 per cent would be required to yield an amount approximating the 1966 level of payments to mining municipalities, and a Mines Profits Tax of slightly more than 6 per cent would, together with the Mines Services Tax, yield approximately the same revenue as the present mining tax. In our view, the rate for the Mines Profits Tax should be governed only by what is deemed to be an appropriate return for the use of the Province's resource. For reasons that we give later, we do not consider that the level of the present tax, considering that it also incorporates a measure of municipal taxation, provides this reasonable return to the Province. *We therefore recommend that:*

(a) The profits tax under The Mining Tax Act be revised so as to impose on the profits of a mine derived from both mining and processing operations a two-stage tax consisting of **32:1**

(i) a flat-rate Mines Services Tax from which payments to designated mining municipalities and other public service expenditures related to mining would be financed, and

(ii) a flat-rate Mines Profits Tax which would yield an appropriate return for the use of Ontario's mining resources.

(b) The profits subject to the Mines Profits Tax be the profits subject to the Mines Services Tax less the Mines Services Tax and the deductions hereinafter recommended by us.

62. We now turn to the consideration of the implications of this recommendation and of various exemptions and deductions that we think should be allowed in computing the profits subject to tax. In so doing, we shall also discuss the deductions allowed under the present system, as well as suggestions made by others for the introduction of new deductions and exemptions.

BASIC EXEMPTION

63. The rates of mining tax now in effect in Ontario do not apply to the first $10,000 of profits, and any mine operator earning a profit of less than $10,000 is exempt from the tax.

64. We have concluded that no exemption should be given in the revised system that we propose. Every profitable mine should make its contribution to the cost of municipal services by way of the Mines Services Tax. The investment allowance that we propose for the Mines Profits Tax is in essence an exemption, and no further relief would be justified. *We therefore recommend that:*

> ***No basic exemption be allowed with respect to the profits subject to either the proposed Mines Services Tax or the Mines Profits Tax.*** **32:2**

EXEMPTION FOR NEW MINES

65. New mines are given an exemption from federal and Ontario income tax for a three-year period beginning when production reaches reasonable commercial quantities. We do not favour a similar exemption for mining tax purposes, its incentive effect notwithstanding.

66. With regard to the proposed Mines Profits Tax, we think that the tax should apply as soon as the profits exceed a reasonable return on the operator's investment. Ontario's return for the use of its resources should not be sacrificed by exemptions to particular classes of taxpayer for incentive or other reasons. If incentives are required, they should be provided by way of grant or subsidy, both being subject to legislative control and review, and not by way of an exemption from tax that remains in effect at the pleasure of the government and that provides no opportunity for the legislature to receive an accounting. The case for providing no exemption from the Mines Services Tax is strengthened by the fact that a mine should, at the very least, start paying its contribution to the cost of municipal services as soon as it earns a profit.

EMERGENCY GOLD MINING ASSISTANCE

67. As we have already pointed out,[11] the Province now in effect imposes mining tax on payments from the federal government to gold mines under the Emergency Gold Mining Assistance Act, inasmuch as in computing the profit subject to the tax, the allowable expenses are reduced pro rata by such cost-aid payments. We also observed that when the E.G.M.A. received by a gold mine exceeds its taxable profits, Ontario taxes nothing but the federal subsidy.

68. Both the federal and Ontario governments include E.G.M.A. in the profits subject to income tax, but the depletion allowance available to a gold mine substantially offsets the effect of its inclusion. Even if this were not so, E.G.M.A. is clearly part of the income of the operator of the mine and so in our view should be subject to income tax and should be included in the profits subject to the Mines Services Tax. We can find no justification for omitting this income for the purpose of determining a mine's contribution to municipal services. We think, however, that there is a valid reason for exempting E.G.M.A. from the Mines Profits Tax—the Province's levy for the use of the resource.

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[11]See paragraph 14.

69. It would not have been economically feasible for many of the Ontario gold mines now receiving E.G.M.A. to have continued in operation if it had not been for this federal cost-aid subsidy. In our view, where the working of the mine is contingent upon the federal subsidy, there is no justification in Ontario's exacting any payment for the use of the resource, for it would be incapable of yielding any return without the federal subsidy. Taxing the federal subsidy, furthermore, diminishes its value and hence in some measure frustrates its purpose. In this connection we observe that mining taxes are recognized as a cost for computing the federal subsidy, so the curious result of including E.G.M.A. in the profits subject to a mining tax is that the greater the E.G.M.A. the greater the mining tax, and the greater the mining tax the greater the E.G.M.A. However, all of the mining tax is not recovered in increased E.G.M.A., partly because not necessarily all of the mining tax is recognized as a cost and partly because the formula is such that only part of the amount included in cost is recovered.

70. Table 32:2 shows that for 1964, the twenty-five Ontario gold mines that received E.G.M.A. would have paid $358,000 less in taxes if E.G.M.A. had been exempt. This represents 2.6 per cent of the total mining tax assessed for the 1964 taxation year. The revenue implications of exempting E.G.M.A. under the present system of taxation would therefore be very small and, because of the introduction of an investment allowance, would be even less in the revised system which we propose.

71. For these reasons, *we recommended that:*

Payments to gold mines under the Emergency Gold Mining Assistance Act be excluded from the computation of profits subject to the proposed Mines Profits Tax. **32:3**

DISCRETIONARY EXEMPTION OF IRON ORE SMELTED IN CANADA

72. The Minister of Mines has had discretionary power from 1907 to remit the tax on iron ore smelted in Canada as an incentive to establish smelting operations in Canada. In practice the Minister invariably remits the tax, but the amounts remitted have been small. The total amount of tax remitted from 1946 to 1964 was $1,117,000. This amount does not suggest that the incentive has had any material effect on the expansion of Canada's steel-making capacity.

73. We think that an exemption at the discretion of the Minister cannot be supported, and, if it is to be retained, it should be given as a matter of right. But, as we have stated in other places in this Report, we do not favour exemptions in the taxation system for particular classes of taxpayers, whether for incentive or other reasons. If incentives are required, they should be provided by way of grant or subsidy which is subject to legislative control and review. Accordingly, *we recommend that:*

The provision permitting the Minister of Mines to remit the mining tax on iron ore smelted in Canada be repealed. **32:4**

INVESTMENT ALLOWANCE

74. We have proposed that the profits subject to the Mines Profits Tax be reduced by an investment allowance approximating a normal return on investment to industry. In view of the tendency of mining companies to finance without long-term borrowing, earnings of companies expressed as percentages of current market prices of shares in their capital stock are relevant in determining what would be an appropriate rate of investment allowance. Investors were willing to pay, on average, prices within the range of thirteen to twenty times the after-tax earnings of the stocks included in the Toronto Stock Exchange index during the period April 1, 1964, to October 31, 1966. The stocks of 122 companies were included in the index at the end of this period. This would indicate that investors during that period were willing to acquire stocks of companies whose earnings figures, then available for the latest twelve-month period, ranged from 5.1 per cent to 7.4 per cent of the week-end closing prices of the stocks.

75. The range of the Toronto Stock Exchange week-end price-earnings ratios for the stocks included in the Toronto Stock Exchange index and certain of its component indexes during the period April 1, 1964, to October 31, 1966, are set out below, together with the range of the companies' earnings, used in computing the ratios, expressed as percentages of the week-end closing prices for the stocks:

Index	*No. of stocks in index at Oct. 31, 1966*	*Week-end price-earnings ratios*		*Earnings as percentage of week-end closing prices*	
		Low	*High*	*High*	*Low*
Toronto Stock Exchange	122	13.53	19.54	7.39	5.12
Industrial	86	13.30	19.67	7.52	5.08
Western oil	9	19.59	40.81	5.10	2.45
Gold	12	15.32	27.19	6.53	3.68
Base metal	15	12.24	16.48	8.17	6.07
Industrial mine	6	13.62	24.84	7.34	4.03

76. The price-earnings ratios reflect the market's evaluation of the appropriate return on investment in common shares, having regard to such particular factors as the earnings history of the company, its current and prospective earnings, its potential for growth, and the degree of risk and special conditions pertaining to the industry. For example, the relatively high prices that investors were willing at times to pay for gold stocks undoubtedly reflects the desire of investors to hedge against, or profit from, any future devaluation of the dollar, and does not in our view indicate the return that investors would ordinarily expect from mining. On the other hand, the price-earnings ratios for the stocks included in the base metal and industrial mine indexes do, in our view, reflect the return that investors believe to be appropriate for substantial producing mining companies that have moved beyond the more risky stage of their existence.

77. The rate of investment allowance that we propose as most appropriate is 12 per cent of investment in mining and processing assets. This would permit a mining company to earn, free of Mines Profits Tax, a net return of 7.84 per cent

after deducting the present effective rates of federal and Ontario income taxes of 34⅔ per cent[12] applicable to mining companies. We do not think that the proposed after-tax return of 7.84 per cent is overly generous, taking into account the high degree of risk attached to the mining industry, which must be assumed particularly by persons who invest in the early stages of mining development. This compares with earnings of the stocks included in the Toronto Stock Exchange indexes, ranging from 3.7 per cent to 6.5 per cent for gold index stocks, 6.1 per cent to 8.2 per cent for base metal index stocks, and 4.0 per cent to 7.3 per cent for industrial mine index stocks. We do not think that the allowance should be higher than 12 per cent because we propose that it apply to the investment in mining and processing assets, without any deduction for borrowed capital or other liabilities such as unpaid accounts. Thus the operator in effect would benefit from the "leverage" which would result from the allowance of a full 12 per cent on assets acquired from capital borrowed at a lesser rate.

78. We must now consider how the operator's investment in mining and processing assets should be determined for the purpose of computing the proposed investment allowance. In our view, this should be the total of the following amounts as at the close of the taxation year:

(a) the cost of all mining and processing buildings and other structures, machinery and equipment less depreciation thereon previously allowed and allowable for the taxation year in determining mining profits;

(b) the cost of exploration and mine development less the portion thereof previously allowed and allowable for the taxation year in determining taxable mining profits;

(c) amounts included in profits in respect of metal or mineral sales that have not been received;

(d) the inventory values of ores, metals and minerals in process, and refined metals and minerals that have been reflected in the determination of taxable mining profits for the taxation year and previous taxation years;

(e) the inventory value of materials and supplies for use in mining or processing operations;

(f) the cost of other assets acquired for the purpose of mining or processing, excluding mining lands or the leasehold or other rights thereto; and

(g) prepaid and unamortized expenditures, including exploration and development expenditures, incurred for the purpose of mining or processing, that, while not deductible in computing taxable mining profits for the taxation year, would be deductible in future years.

79. While the most significant investment in most mining operations is represented by the capital cost of the mining and processing plants, less accumulated depreciation provided thereon, and the unamortized portion of mine exploration and

[12]The combined rate of 52 per cent is reduced to 34⅔ per cent for mining income because of the 33⅓ per cent depletion allowance ordinarily deductible.

development expenditures, mines must also carry other assets of varying importance. For example, some operations, because of their nature or location, require substantial inventories of supplies. Base metal mine operators may have to finance large inventories of metals, and those who ship concentrates to smelters may have to wait several months for final settlement of their accounts. On the other hand, gold and silver producers carry practically no metal inventories and receive prompt settlement from the Mint.

80. The investment allowance should be computed by applying the appropriate rate to the aggregate investment of the operator in all such assets required for the mining and processing operations, and in unamortized mine expenditures without any reduction for the liabilities of the operator, whether they be unpaid accounts, capital loans or debt security issues. On the other hand, we would not allow a deduction for interest in the determination of taxable profits. As indicated previously, this arrangement will greatly favour mine operators, as they would be allowed the 12 per cent investment allowance in respect of assets purchased with borrowed funds.

81. The only asset employed in mining that we would exclude from the base for the allowance is the operator's interest, whether freehold or leasehold, in the mining lands. This interest may have been acquired at little cost through staking, at considerable cost through a purchase for cash, or at uncertain cost through the issue to the vendor of the company's shares, which were recorded in the financial accounts of the company at an arbitrary issued value. The prices paid upon successive transfers of ownership of such mining claims, originally granted by the Crown, might very well have increased with each transfer so that the cost to the final owner, the mine operator who enjoys the investment allowance, might substantially reflect all of the value of the known ore resources. In this event, the mine operator's investment in the mine property represents a capitalization of the future profits of the mine. Including the cost of the mine property in the base for the investment allowance would then have the effect of eliminating most if not all of the excess of profits over investment allowance subject to the Mines Profits Tax. For this reason, and because the mining claims or rights were granted by the Crown at nominal cost to the original owner, we strongly believe that no acquisition cost should be recognized in the base for the investment allowance. *We therefore recommend that:*

(a) The base for computing the investment allowance, deductible from profits subject to the proposed Mines Profits Tax, **32:5**

(i) include the gross investment of the mine operator at the end of the taxation year in all assets acquired for the purpose of the mining and processing operations, as well as the unamortized portion of exploration and development expenditures, and

(ii) exclude the investment in mining lands or any interest in mining lands.

(*b*) ***For the purpose of computing the allowance, the investment of the mine operator in unamortized exploration and development expenditures and in depreciable property be the cost thereof less amounts deducted, deductible or deemed to have been deducted by way of amortization or depreciation in the taxation year and in prior taxation years.***

PROCESSING ALLOWANCE

82. There is no place for a processing allowance under our proposed revised system of taxing mining profits, as we believe that the tax should extend to profits derived from both mining and processing. Nevertheless, we point out that the investment allowance could in the aggregate for all mines greatly exceed the present processing allowance. It would particularly benefit mines in their early stages before they have recovered their capital investment through depreciation and amortization of capital costs.

83. However, even if the present system of taxing profits to the pit's-mouth stage were to be retained, the processing allowance should not be left in its present form. We have four basic criticisms.

84. First, a processing allowance should not be fixed at a percentage of the original cost of the assets, as this ignores the fact that the operator recovers his investment in depreciable assets from his profits by the annual depreciation allowances. Many old mines have recovered virtually all of their investment in processing plants, but they continue to receive a processing allowance based on the original cost. We would favour a greater allowance than 8 per cent—say 12 per cent—applied to the present investment in processing assets, including processing plant at its written-down value.

85. Our second criticism is that we fail to see the justification for the Mine Assessor's practice of modifying the allowance, initially computed at 8 per cent of the original cost of processing assets, by allowing not less than 15 per cent or more than 65 per cent of the combined mining and processing profits. If the allowance is supposed to represent a reasonable return on processing assets, the modification impairs what is already a very rough measure of that return.

86. Third, we think that the allowance should be provided for in the Act or Regulations thereunder, and should not be at the discretion of the Mine Assessor, as it is at present when the value of the ore at the pit's mouth is determined as "the amount at which the mine assessor appraises such output".[13] In addition to our basic objection to provisions in a taxation statute that result in the amount of tax being affected by the manner in which an administrative official or a Minister of the Crown exercises his discretion, we have a particular objection in the case of the mining tax. Here, we think that the manner in which discretion has been exercised with respect to the processing allowance has resulted in substantial inequity as between nickel producers and other mine operators.

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[13]R. S. O. 1960, c. 242, s. 3(3) (c).

87. Finally, we believe that there is no justification for the special allowance to nickel producers. Since 1907 the taxation of nickel companies having extensive processing facilities in the form of concentrators, smelters and refineries has been based on the philosophy that a very substantial part of the profits must be attributed to these ore treatment facilities. The combined effect of the general and special processing allowances granted by the Mine Assessor in his valuation procedure has been to allow a figure close to 25 per cent in recent years rather than the normal 8 per cent of the cost of processing assets. From 1907 to 1955, except for the period 1917 to 1921, 60 to 65 per cent of profits were attributed to processing. Since 1956, a rate has been calculated annually by the Mine Assessor, based on the same premises. While the effective rate of the combined allowances has fluctuated slightly from year to year, 54 per cent of the companies' profits were attributed to processing in the six years 1958 to 1963. The special allowances to nickel mines have substantially reduced the mining tax revenues of Ontario.

88. The calculation of the nickel allowance was fully described by G. R. Mickle, the first Mine Assessor, in a memorandum prepared for the Royal Ontario Nickel Commission, dated November 20, 1916.[14] He had recognized the difficulties encountered by the early refiners in developing methods of separating nickel from copper and other metals associated with it and then refining the nickel. Other evidence submitted to the Commissioners supported the Mine Assessor's position in part. Nevertheless, the Commission concluded that, despite early difficulties, by 1916 several refining processes were in use, and it recommended that the special allowance be abolished and that the tax apply to all profits from the refined metal.[15] Its recommendation was adopted, but the special allowance was revived in 1921 in response to representations to the government by the principal producer of nickel in Ontario.

89. We concur in the opinion of the Royal Ontario Nickel Commission that there are no special conditions affecting the smelting and refining of nickel ores that would justify the assignment of profits to those functions on a more favourable basis than is applied in the case of the processing facilities employed by other mines.

90. For the reasons expressed above, *we recommend that:*

So long as Ontario continues to exempt processing profits from mining tax, **32:6**

> ***(a) the general processing allowance be determined in accordance with provisions in The Mining Tax Act or Regulations thereunder, and that the formula be revised so as to compute the allowance on the written-down value rather than the original cost of assets used for processing, without any minimum or maxi-***

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[14]Royal Ontario Nickel Commission, 1917, *Report*, Toronto: King's Printer, 1917, pp. 198-201 of Appendix.
[15]*Ibid.*, pp. 522 and 523.

mum limitation of the allowance based on combined mining and processing profits, and

(b) the special processing allowance to nickel mines be abolished.

DEPLETION ALLOWANCE

91. The Mining Tax Act does not now provide an allowance for depletion. Under federal and Ontario income tax legislation, the operator of a mine is entitled to deduct a depletion allowance in calculating his income from the mine. To the extent that the allowance constitutes a recognition that the amount of capital invested in the mining resource is wasted by the mining process, it can be justified for income tax purposes by sound accounting principles. However, the allowances given to mine operators for income tax purposes are not based on the cost of the resource to the taxpayer, but are computed as a percentage of profits or a fixed sum per ounce of gold produced. The purpose of the allowance is therefore more to produce an incentive effect than to provide a deduction for the applicable portion of the mine operator's cost of the resource.

92. We reject a depletion allowance for the purposes of a mining tax on two grounds. First, for the same reasons as we developed for excluding the cost of an interest in mining lands from the base of the investment allowance, we see no justification whatever for allowing cost depletion in arriving at the profits subject to mining tax. The original grant of the mining claims or rights came from the Crown at nominal cost, and on their transfer the cost to the present mine operator may have incorporated a capitalization of expected future profits. Ontario's revenue for the use of the resources should not be contingent upon the prices paid when the rights to the resource, granted by Ontario at nominal cost, change hands.

93. Second, if Ontario wishes to encourage mining within the province, we do not think that it should be done by way of an incentive in the form of a percentage-of-profits depletion allowance under The Mining Tax Act. As we said in our discussion of the question of an exemption for new mines, any required incentives should be provided by way of grant or subsidy, which is subject to legislative control and review.

DEPRECIATION ALLOWANCE

94. The Mining Tax Act now provides an allowance of not more than 15 per cent or less than 5 per cent of the cost or value, as determined by the Mine Assessor, of the depreciable assets used for mining. We agree generally with this provision, and suggest that the same rates be allowed for depreciable assets employed in both mining and processing under our proposed system of mining taxation, but that no allowance be made until the assets come into use for the purpose of earning income from mining or processing.

95. While we think that the present rates would be sufficient in almost all cases, it is possible that a mine might have a life that is recognized from the commencement of production to be less than 6⅔ years. Where this can be demon-

strated, we think that a rate based on the expected life of the mine should be allowed by the Lieutenant Governor in Council upon the recommendation of the Minister of Mines. The effect of greater allowances for depreciation would not be as great on the revenue of the Province as one might at first think, because the greater the allowance for depreciation the smaller the investment in the enterprise and, hence, the smaller the investment allowance. *We therefore recommend that:*

The profits subject to the proposed Mines Services and Mines Profits Taxes be reduced by depreciation allowances on depreciable assets employed in mining and processing at the rates now set out in the Act, provided that where it can be demonstrated that the life of the mine is less than 6⅔ years, the Lieutenant Governor in Council may, upon the recommendation of the Minister of Mines, allow a greater rate based upon the expected life of the mine. **32:7**

WORKING EXPENSES

96. We have set out in Table 32:1 a list of expenses that the Ontario Mine Assessor does not consider to be "proper working expenses of the mine" under the present provisions of The Mining Tax Act. It is our view that all expenses that are ordinarily deductible by a corporation in computing its income for federal and Ontario income tax purposes should, with the exceptions we state below, be deductible for mining tax purposes in whole if the only activity of a corporation is mining and processing, or in part if it also carries on any other activity. In the latter event, it would be necessary to make an allocation on a reasonable basis, perhaps similar to the method used to allocate income among provinces for the purposes of corporation income tax. In our view, the allowable expenses should not be restricted to those that directly relate to the mining and processing operations, but should extend to all expenses that are necessarily incurred in carrying on business in corporate form, with the exception, for the reasons given later, of interest and financing costs, royalties and rentals other than those payable to the Crown and, for the purposes of the Mines Services Tax, municipal property taxes. *We therefore recommend that:*

All expenses allowable for income tax purposes, with the exception of interest and financing costs, royalties and rentals in respect of mining lands or rights other than those payable to the Crown, municipal property taxes and allowances for depletion of mine, be allowable in computing profits of a corporation subject to the proposed Mines Services and Mines Profits Taxes, in whole if the corporation had no other business activity or source of income, and to the extent reasonably apportionable to the business of mining and processing if it did have another business activity or source of income. **32:8**

MUNICIPAL TAXES

97. At the present time, the Mine Assessor does not allow any deduction from profits subject to mining tax for municipal taxes on property that is not exempt from municipal taxes under The Assessment Act. Under that Act, mines are exempt from taxation by municipalities and school boards in respect of mine buildings, plant and machinery and the minerals in or on the land. Operators of mines do, however, pay taxes to municipalities and school boards in respect of office buildings, dwellings and other non-exempt property.

98. In our view any municipal taxes paid on non-exempt property to municipalities and school boards used for the purpose of earning income from mining and processing should be allowed as a deduction from profits subject to the Mines Profits Tax. This is consistent with our recommendation that the profits subject to this tax be reduced by the amount of the Mines Services Tax, which would be payable in lieu of municipal taxes on exempt mine property.

99. For these reasons, *we recommend that:*

The profit subject to the proposed Mines Profits Tax be reduced by the amount of taxes paid by the mine operator to all municipalities and school boards on non-exempt property used directly or indirectly for the purposes of deriving income from mining or processing. **32:9**

INTEREST AND FINANCING COSTS

100. Interest is not allowed as a deduction from profits under the present system of taxing mining profits. In our view, the amount of the tax exacted for the use of the resource, under both the present and the proposed systems, should not vary with the source of capital, whether borrowed or contributed by the mine owner or the shareholders of a mining company. Therefore, either interest should not be allowed on borrowed capital or a reasonable return should be allowed on all forms of capital used in earning the profits such as would be provided by the investment allowance we propose.

101. The investment allowance we propose would be computed by reference to the mine operator's gross investment in mining and processing assets, without any deduction for borrowed capital or other liabilities including unpaid accounts. As the mine operator would be allowed 12 per cent for his gross investment, including the part financed with borrowed money, interest on the borrowed capital and other financing costs obviously should not be allowed as a deduction in computing profits in addition to the investment allowance.

ROYALTIES AND RENTALS

102. We agree with the present provision of The Mining Tax Act that states that no allowance or deduction is to be made in computing profits for "royalties paid for or in respect of the output of a mine situated on lands not the property

of the Crown". The effect of this provision is to prohibit the deduction of all mine royalties except those payable to the Crown.[16]

103. Ontario's return for the use of the resource should not be affected by any royalty or rental payable out of production from or in respect of mining lands, originally acquired from the Province at a nominal cost, under agreements made upon transfer or sale to subsequent owners. Profits, while diverted from the mine operator to the holder of the royalty interest, are nevertheless profits and should be subject to the tax.

104. From the above it will now be seen that we do not favour

(a) including in the base the acquisition cost of an interest in mining lands or rights for the purposes of the investment allowance,

(b) the deduction from profits of an allowance for depletion based on the cost of acquiring an interest in mining lands or rights or on any other basis, or

(c) the deduction from profits of a royalty or rental paid for or in respect of the output of a mine situated on privately owned mining lands or paid to the lessor of mining rights.

It may be argued that the reverse should be favoured in all three situations, and that Ontario should apply the mining tax to the vendors of mining lands and the recipients of mine royalties or rentals. While this has some appeal in theory, it would entail many difficulties in practice.

105. First, the tax would need to be extended to every staker and subsequent owner upon the sale or resale of his interest in mining claims, lands or rights with all the attendant problems of valuation of the consideration received or contingently receivable in the form of shares of a mining company. It would in effect be a capital gains tax on one form of property to the exclusion of other forms, and therefore might be held to be discriminatory.

106. Second, while taxable royalties and rentals would be comparatively easy to identify, it would be necessary to grant an investment allowance on the capital cost to the recipient of the interest in the mining lands or rights he had retained. This would involve an apportionment of the total cost to the recipient in the event that he sold his interest subject to a royalty interest reserved for himself.

107. Third, while it may sometimes be fair to include the cost of an interest in mining lands or rights in the base for the investment allowance and allow depletion in respect of the cost as a deduction from profits, it would not be so if the profits realized on the sale of the interest to the present owner had not been taxed at the time in the past that the sale was made.

108. Finally, all present mine operators acquired their interests in mining lands and rights, or undertook to pay mine royalties or rentals in the full knowledge

[16]Under present practice Ontario does not impose royalties in respect of Crown-owned mining lands.

that, under the law then existing, depletion was not allowable for mining tax purposes and that non-Crown mine royalties and rentals would not be allowed as a deduction from profit subject to mining tax. For their part, the lessors who rented or the vendors who reserved a royalty interest made their contracts at a time when the rental or royalty was not subject to mining tax. A change now, whereby the mine operator would be allowed a deduction from his profits and the lessor or vendor would be taxed in respect of the royalty or rental, would have a substantial effect on the financial result of the transactions made earlier between the parties. On the other hand, in contracts entered into after such a change in tax treatment, one would expect to find—other things being equal—higher royalties or rentals than those in contracts negotiated before the change, the increase being approximately the amount of tax involved. The reasons for making such a change are not good enough to warrant the hardship that would burden persons receiving mine royalties or rentals under existing contracts.

EXPLORATION AND DEVELOPMENT EXPENDITURES

109. As explained in paragraph 15, the operator of a mine is not at present permitted to deduct from the profits of the mine any exploration or development expenditures incurred in respect of that mine prior to the commencement of production therefrom. If, however, at the time expenditures for exploration and development work done in Ontario are incurred, the mine operator earns profits from another mine operating in Ontario, he is required to deduct from the profits of the other mine at least 15 per cent, and he may deduct up to 100 per cent, of these expenditures incurred in the year. If he claims less than 100 per cent, he can carry forward the portion not deducted and write it off against the profits of the other mine in subsequent years. The result of this rule is that if the mine operator does not have another mine in production when the expenditures are incurred, he is confronted with the discouraging fact that he will never get a deduction for his expenditures. A new operator is hurt by this treatment but not the long-established, prosperous mining company that already has an operating mine in Ontario. The inequity of this provision is manifest; it must be corrected.

110. We propose that a distinction be made between expenditures for exploration and those for development. For our purpose we would define exploration expenditures as including expenditures on a mine property prior to the point of shaft-sinking in an underground mine, or stripping of over-burden in an open-pit operation. On the basis of this definition it will readily be seen that exploration expenditures ordinarily would have less permanent value than development expenditures. We therefore propose that in computing profits subject to the Mines Profits Tax, a mine operator be required to deduct in the year expenditures incurred within the year on exploration carried on in Ontario to the extent that the profits otherwise taxable from all of his Ontario mines permit, and that any portion of such expenditures not so deducted be deductible in future years to the extent that the profits otherwise taxable in each successive subsequent year permit.

111. In our view, mine development expenditures are part of the capital cost of the mine which should be amortized by annual deductions from profits of the

mine subject to the mining tax. We do not think that there should be an unlimited deduction, as is now given if the operator happens to have a second producing mine; nor do we think that any deduction should be allowed from the profits of another mine before the mine that is being developed has come into production in reasonable commercial quantities[17]. Thereafter, we would allow a deduction for the purposes of both the Mines Services Tax and the Mines Profits Tax in computing the combined profits from all mines operated by the taxpayer in Ontario.

112. The annual rate of allowance that we propose is not less than 10 per cent and not more than 20 per cent of the total expenditures. This would mean that, beginning with the year that the mine comes into production in reasonable commercial quantities, a deduction of at least 10 per cent of the expenditures would be mandatory and a greater deduction up to 20 per cent would be permissive. We think this rate would be sufficient to amortize the expenditures over the predictable life of almost any mine, but we none the less believe that if it can be demonstrated at the commencement of production that a mine is likely to have a life of less than five years, a rate based on the expected life of the mine should be allowed by the Lieutenant Governor in Council upon the recommendation of the Minister of Mines.

113. We do not propose that any deduction be allowed for exploration expenditures in computing the profit subject to the Mines Services Tax because we do not wish to suggest any further narrowing of the profit base used for determining a mine's contribution to the cost of municipal services. We recognize that this appears to be a departure from principle inasmuch as exploration expenditures would properly be deductible in computing the true profit from the activity. On the other hand, the Mines Services Tax should not be so structured that its revenue would fluctuate with the extent of exploration a mine operator might choose to perform in the year on other properties, which might well be outside the locality in which the mine is located.

114. *We therefore recommend that:*

(a) The profits subject to the proposed Mines Profits Tax be mandatorily reduced by the amount of expenditure on exploration in Ontario incurred in the year, and incurred in previous years but not deductible in such years, but that such deduction be limited to the amount of profits otherwise subject to the tax; **32:10**

(b) the profits subject to both the proposed Mines Services Tax and the proposed Mines Profits Tax be reduced by an annual allowance of 10 per cent of expenditures on mine development in Ontario, which, at the option of

[17]Under the federal Income Tax Act and the Ontario Corporations Tax Act the present three-year exemption from income tax for a new mine commences with the day on which the mine comes into production "in reasonable commercial quantities".

the mine operator, may be increased to a rate not exceeding 20 per cent, provided that where it can be demonstrated that the life of a mine is less than five years, the Lieutenant Governor in Council may upon the recommendation of the Minister of Mines allow a greater rate based upon the expected life of the mine; and

(c) the above allowances be deductible from the combined profits of all mines operated by the taxpayer in Ontario, but that the allowance for mine development expenditures not commence until the year that the mine for which the expenditures are incurred comes into production in reasonable commercial quantities.

115. Certain transitional arrangements would be required for several years following the adoption of the proposal outlined above. Otherwise, mine operators who brought their first Ontario mine into production in the few years prior to the introduction of the new system might be treated inequitably. We propose that mine operators who had incurred expenditures for exploration and development work done in Ontario in the period prior to the effective date of the new tax system be deemed to have been previously allowed, in respect of each prior year's exploration and development expenditures in such period, the greater of the amounts actually allowed in such years under the old system or 20 per cent of the expenditures for each year beginning with the commencement of production of the mine in reasonable commercial quantities. This would be necessary in computing the deductions to be made from profits for the investment allowance as well as the allowances for exploration and development; the former would be dependent upon the investment in unamortized expenditures after deducting the deemed allowances.

116. It might be helpful to illustrate what we have in mind by citing an example which assumes that the new system and the transitional provisions become effective in 1968. A mine operator, with no other mine in Ontario, whose production in reasonable commercial quantities began in 1966, would have had no opportunity to deduct any portion of his exploration expenditures prior to 1968 and so would be deemed to have been allowed in the years 1966 and 1967 a total of 40 per cent of exploration expenditures and 40 per cent of mine development expenditures. He would be required to deduct the remaining 60 per cent of his exploration expenditures from his 1968 profits to the extent that those profits permitted, and, if the profits of 1968 were not sufficient, he would be required to deduct the expenditures from the first available profits of future years. He would be permitted to deduct as much as 20 per cent of the development expenditures in each of the years 1968, 1969 and 1970, but in any event would be required to deduct at least 10 per cent per annum until such time as a total of 60 per cent had been deducted.

117. As a transitional provision, *we therefore recommend that:*

For the purpose of computing the deductions from profits for exploration and development, and the investment allowance, a mine operator who has incurred exploration expenditures and expenditures for the development of a mine that had not come into production in reasonable commercial quantities at the effective date of the revised system of taxation which we recommend, or that had come into production in the four-year period prior to the effective date, be deemed to have been allowed in respect of such expenditures in the period prior to the effective date of the new system the greater of 32:11

(a) the amounts actually deducted in the computation of his mining tax under the old system, or

(b) 20 per cent for the year that the mine came into production and 20 per cent for each year thereafter prior to the effective date of the new system.

MINING LOSSES

118. The income tax statutes of both Canada and Ontario allow business losses sustained in a taxation year to be deducted from the business income of a taxpayer for the preceding year, and, to the extent that this does not absorb the loss, from the business income of the succeeding five taxation years. There is at present no similar provision in The Mining Tax Act.

119. We are impressed with the need for a loss carry-over provision in the computation of mining profits in order to offset the inequity of imposing a tax on the annual profits of profitable years without any recognition of losses in other years. This could result in taxing a much greater total amount than the lifetime profit of the mine. Mines may have losses in their initial years, and they almost invariably have losses in their final years because of a reluctance to discontinue operations as soon as they become unprofitable and because of the effect of severance pay. Without a loss carry-over provision, the effect of the tax is clearly inequitable.

120. Because of our concern for mines that have losses in their final years, we propose that mines be allowed to carry their losses back two years and, as for income tax purposes, they be permitted to carry losses forward five years. We suggest, however, that the deduction be allowed only from profits subject to the Mines Profits Tax, which represents Ontario's levy for the use of the resource. We do not think that it should extend to the Mines Services Tax as this represents the mine's annual share of the cost of municipal services, and the tax should be just as final as if the mine had been subject to municipal property and business taxes in the ordinary way. Also, the mines should contribute to the cost of municipal services when they are profitable, regardless of past or future losses. In our view, it is sufficient to exempt them from contributing in the loss years.

121. It would not be desirable to allow a reduction for losses incurred in years prior to the introduction of the proposed new system because the computation of profits and losses under the new system, with its many differences in treatment, could vary substantially from the computations under the legislation in effect at the time the losses were incurred. Furthermore, the amount of loss deductible should be the loss exclusive of the amount of investment allowance to which the mine operator was entitled for the loss year, as the investment allowance does not represent an expenditure of money. *We therefore recommend that:*

> ***The profits subject to the proposed Mines Profits Tax be reduced by losses from mining and processing incurred in the five preceding and the two succeeding taxation years, to the extent that profits of any preceding taxation year have not already been reduced by such losses, but that such deduction be limited to losses, excluding an investment allowance, incurred in the fiscal year that the proposed system becomes effective and in subsequent years.*** **32:12**

RATE OF TAX: ECONOMIC AND FISCAL CONSIDERATIONS

122. We believe that inasmuch as the proposed system of taxation would considerably increase the equity of mining tax, it would tend to encourage rather than discourage mining activity in the province. We should assume that no mining venture would be delayed or abandoned because of the consequences of the mining tax unless the Province were to establish a rate for the Mines Profits Tax that greatly exceeds the rate we contemplate. Unquestionably the burden on certain mine operators will be increased, but only if they have been treated with undue generosity in the past.

123. We have already stated that the rate for the Mines Profits Tax should be governed solely by what is deemed to be an appropriate return for the use of the Province's resource, and not by the revenue needs of the government, and that in our opinion the present tax, considering that it also incorporates a measure of municipal taxation, does not provide a reasonable return. As indicated by Table 32:6, the present mining tax amounts to less than 2 per cent of the value of production from all of Ontario's mines. It does not, therefore, represent a significant cost of mining.

124. Undoubtedly, a substantially higher tax rate could place Ontario in an unfavourable position relative to other provinces. However, from Table 32:4 it is obvious that none of the other major metal-producing provinces offers as low a rate structure as Ontario, taking into account that one-third of the Ontario rate is employed to provide municipal revenues, which in the other provinces are provided by additional municipal taxes and other levies. With the change in tax base that we propose, we think that the Province could participate extensively in the Mines Profits Tax without discouraging mining activity, and the 12 per cent rate we propose later in conjunction with an investment allowance will still compare favourably with the rates imposed by most other major metal-producing provinces.

TABLE 32:7

COMPARISON OF MINING TAX ASSESSED FOR 1962 WITH ESTIMATE OF PROPOSED TWO-STAGE TAX AS APPLIED TO THAT YEAR ASSUMING 3 PER CENT MINES SERVICES TAX AND 12 PER CENT MINES PROFITS TAX
(thousands of dollars)

	Mines subject to both Services and Profits Tax	*Mines subject to Services Tax only*	*All mines*
Number of Mining Companies	25	40	65
TAX UNDER PRESENT LEGISLATION*			
Taxable profits less losses	119,535	6,210†	125,745
Tax assessed	12,292	320	12,612
Deduct provincial government payments to mining municipalities‡	5,449	142	5,591
Retained by Province for use of resource	6,843	178	7,021
Percentages of taxable profits less losses represented by:			
Tax assessed	10.28%	5.15%	10.03%
Provincial payments to mining municipalities	4.56	2.29	4.45
Retained by Province	5.72%	2.86%	5.58%
PROPOSED TWO-STAGE TAX			
Profits less losses	186,627	9,458†	196,085
Mines Services Tax at 3% rate	5,599	299	5,898
	181,028	9,159	190,187
Deduct:			
Emergency Gold Mining Assistance*	769	8,805	9,574
Allowance for exploration	3,927	1,144	5,071
Investment allowance	66,095	22,803	88,898
	70,791	32,752	103,543
Profits subject to Mines Profits Tax	110,237	(23,593)	86,644
Mines Profits Tax at 12% rate	13,228	—	13,228
Balance of profits retained by mines before income taxes	97,009	(23,593)	73,416
Estimated investment in mining and processing assets§	550,701	189,917	740,618
Percentages of investment retained by mines			
E.G.M.A.	.14%	4.64%	1.29%
Investment allowance	12.00	12.01	12.00
Balance of profits before income taxes	17.62	(12.42)	9.91
Total	29.76%	4.23%	23.20%
Taxes as percentages of investment			
Mines Services Tax	1.02%	.16%	.80%
Mines Profits Tax	2.40	—	1.79
Total	3.42%	.16%	2.59%

*Source: Figures prepared by Ontario Mine Assessor's Branch.

†Losses of $481,000 deducted.

‡Payments made in Province's fiscal year ended March 31, 1963, prorated on basis of taxable profits, less losses.

§While investment in mining and processing assets has been estimated by reference to financial statements of the mining companies, an exact computation would differ to some degree.

Ontario's mineral production, exclusive of fuels and structural materials, is largely metals. The Province holds a substantial lead over all other provinces in metal production, as demonstrated by Table 32:5. The present rates of mining profits tax for the four provinces with the next largest productions of metals are as follows:

Quebec	— 9 to 15 per cent of profits over $50,000.
Newfoundland	— 20 per cent of profits of iron mines but tax not to exceed 10¢ per ton on first 1,500,000 tons and 8¢ per ton on each additional ton. (Production of other metals is not significant compared to Canada's total production.)
British Columbia	— 10 per cent of profits over $25,000.
Manitoba	— 6 to 11 per cent of profits.

125. With the generous co-operation of all taxable Ontario mining companies, our Committee made a study of their mining tax returns for their 1962 taxation year. The 1962 profits and assessed taxes are set out in Table 32:7. In addition, we show in this Table an estimate of what the impact of the proposed Mines Services and Mines Profits Taxes would have been at the rates of 3 per cent and 12 per cent respectively, if they had been applied in 1962. The yield from the proposed Mines Profits Tax—of $13.2 million—compares with $7 million which was left for the Province out of the amount actually assessed for 1962 after deducting payments made by it to mining municipalities.

126. If Ontario mining companies had been subject to mining tax on their 1962 mining profits under present Quebec laws and rates, we estimate that their tax liability would have amounted to slightly less than $18 million. Under Manitoba laws and rates, the amount would have been in excess of $13 million. In Table 32:8, the amounts of Ontario tax actually levied after deducting payments to mining municipalities, the estimated amounts payable under Quebec and Manitoba legislation, and the proposed Ontario Mines Profits Tax are expressed as percentages of a common base. This base is the amount of profits actually assessed in Ontario plus the special processing allowances to nickel mines and less provincial payments to mining municipalities. This base is roughly equivalent to the amounts that would have been taxed in Manitoba and Quebec, assuming that the mining companies would have paid in those provinces municipal taxes or similar levies of the same order as the payments made by Ontario to the mining municipalities. The major differences that are not reflected in the base are the variances in depreciation allowances and the difference between the Quebec allowance for pre-production expenses and the amounts actually allowed by Ontario to the operators of producing mines for development expenditures of other mines not yet in production. Finally, the comparison in Table 32:8 ignores the 50 per cent reduction in tax that Manitoba allows in the first three years of production; few, if any, of the mines involved would have been eligible for this relief. Because of these differences, the comparison is not exact, but it is close enough to draw valid conclusions.

TABLE 32:8

ESTIMATED PROFITS TAXES WHICH WOULD HAVE BEEN PAYABLE ON 1962 PROFITS OF ONTARIO MINES UNDER PRESENT ONTARIO, QUEBEC AND MANITOBA, AND PROPOSED ONTARIO RATES

(Expressed as percentages of profits assessed by Ontario, before deducting special processing allowances to nickel mines, and less provincial payments to mining municipalities*)

Present Ontario Mining Tax†	4.50%
Quebec‡§	11.49
Manitoba§	7.97
Proposed Ontario Mines Profits Tax**	8.48

*As neither Quebec nor Manitoba allows any class of mines a special processing allowance in addition to the general allowance, and the general allowance has a higher minimum for certain metals in Manitoba, and as municipal taxes or other imposts are levied in Manitoba and Quebec, it is necessary to relate the various taxes to a common base. The base chosen is approximately the amounts that would be subject to tax under Quebec legislation.

†Present Ontario taxes are reduced by provincial payments to mining municipalities paid in lieu of levying municipal property and business taxes, as municipal taxes are ordinarily levied in Manitoba and Quebec and are deductible from profits subject to mining tax.

‡Does not take fully into account allowances for pre-production expenses permitted under Quebec legislation.

§Does not take into account possible variances in allowances for depreciation.

**Proposed Ontario tax does not include the Mines Services Tax, which is proposed in lieu of assessing municipal property and business taxes.

127. The Mines Services Tax should be set at the rate needed to finance payments to designated mining municipalities, and we make recommendations concerning the level of these payments in Chapter 12. We estimate that, having regard to the present levels of mine earnings, a 3 per cent rate would have been adequate for 1966.

128. We suggest that the rate for the Mines Profits Tax should be set initially at 12 per cent. While this is much below the present level of mine taxation in Quebec, it is close to that in Manitoba, and represents in total a substantial increase for Ontario mines. The combined Mines Services and Mines Profits Taxes, based on 1962 figures, would be over 50 per cent greater than the present level of taxation. However, as seen from Table 32:7, forty of Ontario's sixty-five mines would in the aggregate pay less than before; only those mines with high profitability in relation to investment would pay more, with a considerable part of the increase being accounted for by the elimination of the special processing allowance to nickel mines. Finally, it should not be overlooked that only part of the increase would be borne by the mines because of the deduction allowed for mining taxes in the computation of profits subject to federal and Ontario corporation income taxes.

129. We suggest further that consideration be given to an adjustment in the rate of Mines Profits Tax if the experience gained in the first few years of operation of the new system results in a public revenue of smaller proportions than estimated by us in Table 32:7. It will be noted that under the proposed system the twenty-five mines that would have been subject to the Mines Profits Tax for

1962 would have retained after-tax income equivalent to 29.76 per cent of their investment and the Province would have received a return equal to 2.40 per cent of such investment—which means that Ontario would have taken about 7.5 per cent of the before-tax over-all earnings of the twenty-five taxable mines. To put this another way, it will be seen from Table 32:8 that if the proposed Mines Profits Tax had been applied in 1962 it would have been equivalent to 8.5 per cent of the before-tax profits of the twenty-five mines after deducting the general processing allowances actually granted in 1962 and an amount equal to the provincial payments made to mining municipalities in that year in lieu of their levying municipal property and business taxes. We think that a weight of taxation within the approximate range of the results indicated by these two tests would be a fair return for the Province.

130. *We therefore recommend that:*

The proposed Mines Services Tax be established at the flat rate required to yield an amount approximately equivalent to the aggregate of the payments to be made by the Province to designated mining municipalities, and the proposed Mines Profits Tax be established initially at the rate of 12 per cent. **32:13**

ADMINISTRATION AND APPEALS

131. The Mining Tax Act is at present administered by the Mine Assessor who, while appointed by the Lieutenant Governor in Council, is an officer of the Department of Mines and is subject to the direction of the Minister of Mines. The Mine Assessor has broad powers to determine the value of the output of a mine and the amount of expenses to be allowed as deductions. When he has audited the tax returns, sent notices of assessment to the persons liable for the assessment and prepared the tax roll, and when the time for filing notices of appeal has expired, the tax roll is approved by the Minister of Mines. It then becomes final and conclusive against each person mentioned therein unless an appeal has been entered.

132. We question the wisdom of giving responsibility for the collection of a tax to an official of the department that is responsible for the control and development of the industry subject to the tax unless there are strong overriding technical or administrative considerations. For example, we think that it is appropriate that the Department of Lands and Forests collect Crown dues and tenure charges on timber because there are technical problems involved in the determination of the charges that can best be handled by the officials of that department. Similarly, the Department of Transport should collect the motor vehicle permit and licence revenues because of the administrative problems in issuing permits and licence plates.

133. The above considerations are not present in connection with the mining tax, where the determination of profits is now basically an accounting matter, and would be even more so under the proposed system of taxation by which an

appraisal of the mine output would no longer be required. We think that the Province will be better assured of its revenues and the mine operators of fair treatment if the collection of the tax were to be transferred to a department that is not involved in the promotion of mining. Where disputes involving technical matters arise, the views of the Department of Mines should be sought by the collecting department for guidance in settling the issue.

134. In our view, the collection of the mining tax should be a function of the proposed Department of Revenue; the Comptroller of Revenue is currently responsible for collecting corporate income tax from mining companies and is in a good position to ensure that the treatment given under The Mining Tax Act is, where appropriate, consistent with that under The Corporations Tax Act. If, as we recommend, the collection of corporation income tax on Ontario's behalf is delegated to the federal government, the Comptroller of Revenue would still have income tax information from the federal government available to him, which would be helpful in the determination of mining profits subject to the mining tax.

135. For the reasons expressed above, *we recommend that:*

The administration of The Mining Tax Act be transferred from the Department of Mines to the proposed Department of Revenue. **32:14**

136. As already explained, appeals in the first instance are referred by the Minister of Mines to the Mining Commissioner or the Ontario Municipal Board as he sees fit, and appeals from the decision of either may be taken to the Court of Appeal. In practice, the decision whether an appeal is referred to the Mining Commissioner or the Ontario Municipal Board has been made without regard to the points at issue, the expedition of the appeals being the Minister's only concern. In our view, the appeal procedure recommended in Chapter 25, for the reasons there given, should be applicable to appeals from assessments under The Mining Tax Act.

DEDUCTIBILITY OF MINING TAX FOR INCOME TAX PURPOSES

137. Both the federal Income Tax Act and the Ontario Corporations Tax Act allow a deduction from income in respect of mining tax but the deduction is restricted to the amount allowed or permitted by regulation. While not identical, the regulations under the two statutes are substantially similar, although there is a significant difference in their administration, with the result that Ontario mining companies can be unreasonably deprived for federal income tax purposes of the deduction of much or all of the mining tax they pay.

138. The federal administration's interpretation of its regulation[18] has recently been upheld by the Exchequer Court of Canada.[19] In our view, the effect of the regulation is capricious and can result in substantial inequity as between mining

[18]Regulation 701 under the Income Tax Act.

[19]*Quemont Mining Corporation Ltd., Rio Algom Mines Ltd., and MacLeod-Cockshutt Gold Mines Ltd.* v. *M. N. R.*, 66 D.T.C. 5376.

companies. We therefore think that the Crown might better have used its energy in making the regulation more equitable rather than in concentrating on its enforcement. If we may digress, we are strongly of the opinion that government departments charged with the responsibility of collecting tax should not ignore their equally great responsibility of initiating or suggesting changes in the law where its application results in substantial inequity or has unintended onerous effects.

139. The purpose of the Regulation is to exclude from the deduction any portion of a provincial mining tax that is levied on income from sources other than mining. Examples of such other sources would be processing profits, where a mining tax is levied by a province on profits from both mining and processing, or where a provincial determination of mining profits allows a smaller deduction for profits from processing than is prescribed in the federal regulation.

140. The difficulty with the Regulation as interpreted by the federal administration is that the deduction for income tax purposes is limited to that proportion of a provincial mining tax that the income derived from mining operations in the province, as determined under the federal Income Tax Act and its Regulations, bears to the amount of profit subject to tax under the provincial Mining Tax Act. Thus, the portion of the tax that may be deducted is reduced to a fraction of which the numerator is unrelated to the denominator inasmuch as the income computed under one statute can be quite different from what is computed under another statute. The result is that where a province imposes a rate of mining tax on the same basic amount of profit as determined under the federal statute, the whole of the mining tax can be deducted. On the other hand, if the province assesses the same amount of tax by charging half the rate on double the basic amount of profit, the deductible amount is halved. The formula, because of this basic weakness, produces many anomalies, which have been brought to the attention of the federal government on several occasions.[20] The wording of the regulation was the outcome of a conference of federal and provincial officials, and in our view, if the present structures of the Ontario mining and federal income taxes are continued, Ontario should seek another meeting to undo the damage.

141. *We therefore recommend that:*

Pending any revision of the structures of Ontario mining tax and federal income tax, Ontario press the federal government for a change in Regulation 701 under the Income Tax Act so that mining taxes, except to the extent that they are imposed on processing profits or other income which is not derived from mining, will be fully deductible from income for federal income tax purposes. **32:15**

142. The proposals we have made for revising the structure of the Ontario mining tax may appear to result in the imposition of mining tax on processing

[20] See Submission by Tax Committee of the Canadian Metal Mining Association to the Department of National Revenue, November 12, 1962.

as well as mining profits. However, in respect of the proposed Mines Profits Tax we recommend the deduction from profits of a generous investment allowance, which in the aggregate for all mines will greatly exceed the allowance under the present statute for processing profits. It is therefore reasonable to suggest that for income tax purposes, the whole of the Mines Profits Tax be deductible from income. The Mines Services Tax is in essence a profits-based tax of an amount equal to the payments which the Province makes to municipalities in lieu of their imposing a similar total amount of property and business taxes on the mines. There should therefore be no greater hesitation in allowing a full deduction from income for the Mines Services Tax than if the mines had paid the same amount as municipal taxes. *We therefore recommend that:*

Upon the adoption of the revised system of taxing mining profits recommended by us, Ontario press the federal government to make such changes in Regulation 701 under the Income Tax Act that all of the mining tax payable by Ontario mines will be deductible for income tax purposes. **32:16**

TABLE 32:9

PROVINCIAL MINING LAND TAXES AND RENTALS IN CANADA, 1967
Summary of Rates and Bases

Province	*Taxable Property*	*Rate*
British Columbia	Mineral claims granted by the Crown, except oil and gas, sand, gravel and building stone.	25¢ per acre
Alberta and Saskatchewan	Mineral tracts	3¢ per acre
	Assessed value of minerals in producing areas as designated by order-in-council.	0.8%
Manitoba	Assessed value of minerals in producing areas as designated by order-in-council.	0.8%
Ontario	Mining lands and rights.	10¢ per acre
Quebec	Undeveloped mining lands under lease from the Crown:	
	First and second years	$1.00 per acre
	Third and fourth years	$2.00 " "
	Fifth and sixth years	$3.00 " "
	Seventh and eighth years	$4.00 " "
	Ninth and tenth years	$5.00 " "
	Thereafter, each year	$6.00 " "
	Mining concessions granted after July 1, 1911; effective on the first day of January following the expiration of 2 years from the date of the concession. (The tax is remitted when exploration or mining costs exceed $10.00 per acre on each concession.)	$1.00 " "
Newfoundland	The assessed value of hematite contained in mineral lands, except those granted under the Veterans' Land Act—not to exceed	1.0%
Nova Scotia	Lands under Crown lease where lessee is exempted from or receives an extension for the performance of work on the lease—lessee required to pay in addition to rentals a fee per acre, according to section of statute under which exemption or extension granted.	50¢ or $1.00 per acre

THE MINING ACT

ACREAGE TAX

Historical Background

143. The first tax imposed on mining lands in the province was The Algoma Land Tax Act of 1868, which levied a tax of 2¢ per acre per annum on mining lands in the Algoma region and later on all patented lands in unorganized territories, except those used for agriculture. The Algoma Land Tax Act was superseded in 1907 by an acreage tax, imposed under legislation that in 1914 was embodied in The Mining Tax Act, and acreage tax continued to be imposed by the latter Act until 1955 when it was incorporated into The Mining Act. Rates of the acreage tax rose fairly slowly, from 2¢ an acre in 1907 to 10¢ an acre in 1946, at which level it has remained to the present time.

Similar Taxes in Other Provinces

144. Alberta and Saskatchewan both impose annual acreage taxes of 3¢ per acre per annum on designated mineral tracts, while British Columbia imposes a similar tax of 25¢ per acre per annum. Nova Scotia charges a rental fee of 50¢ or $1.00 per acre, according to the circumstances, where a lessee is exempted from, or receives an extension of time for, the performance of work on a lease. In 1965 Quebec enacted the Mining Act[21] which provides for the granting of leases instead of concessions as formerly, and for the payment of an annual rental of $1.00 per acre. Such leases obligate the holders to commence mining operations within two years; however, where a delay in commencing operations is granted, the annual rent is increased by $1.00 for each two years after the first two years, to a maximum of $6.00 per acre per annum which is reached after the tenth year. The annual tax on undeveloped mining concessions was at the same time increased by Quebec from 10¢ per acre to $1.00 per acre, but this tax is remitted upon proving that exploration work or mining operations amounting to $10.00 per acre have been carried out on each concession.

145. Alberta, Saskatchewan and Manitoba each impose a tax of 0.8 per cent of the assessed value of minerals in producing areas as designated by order-in-council, and Newfoundland, by legislation which became effective January 1, 1965, provides for a tax not exceeding 1.0 per cent on the assessed value of hematite contained in mineral lands except those granted under the Veterans' Land Act.

Justification

146. The tenure of mining lands has been considered in the reports of four previous public inquiries, all of which commented on the use of the acreage tax as a possible deterrent to hoarding and concluded either that the then existing rate should be increased or that the rate was not sufficient to discourage owners from retaining land.

147. The Royal Ontario Nickel Commission, 1917,[22] was satisfied that an attempt to collect a substantial revenue by an acreage tax would be hopeless, but

[21] S. Q. 1965, c. 34.

[22] Royal Ontario Nickel Commission, 1917, *Report*, p. 512.

that "the acreage tax . . . serves useful purposes in this Province. In default of payment for two years, the lands may be forfeited to the Crown, and again opened for location. . . ." At the time of the report, the rate was 2¢ per acre, and this the Commission concluded "is much too low".

148. The Royal Ontario Mining Commission, 1944,[23] recommended that to provide for the expense of an annual notice to the holders of patented mining claims of acreage tax owing, "as well as to discourage the holding of idle patented mining claims, the acreage tax be increased from the present rate of 5¢ per acre annually to 10¢ per acre". The Commisson also recommended quick public sale of lands subject to forfeiture for non-payment of acreage tax.

149. The Public Lands Investigation Committee, 1959, referring to the policy before 1957, reported that

> the chief criticism of . . . the administration of public lands for mining purposes was the granting of title in fee simple. . . . It was contended that this was contrary to the principle of multiple land use. While the actual amount of land alienated under The Mining Act, namely, less than one per cent of the area comprising the Precambrian shield, is small, much of this land is being kept from other uses without itself producing mineral of value. The only corrective is the annual acreage tax of 10¢ an acre which generally is not sufficient to discourage the owners from retaining the land.[24]

Later,[25] the Committee observed that there was a preponderance of evidence given that there is a need for long-term tenure of mining lands to facilitate financing and justify the heavy expenditures involved in processing and developing an ore body. While the Committee made no further comment concerning the acreage tax, it recommended that no further patents be granted until a lessee satisfied the Minister of Mines that he had been continuously producing minerals in substantial quantities for more than one year. This recommendation was implemented by a 1963 amendment to The Mining Act.

150. The Select Committee on Mining of the Ontario Legislature recommended in 1966 that the acreage tax on mining lands and mining rights be increased from the present 10¢ an acre to 25¢ for the reasons expressed in the reports of the Royal Ontario Nickel Commission and the Royal Ontario Mining Commission. The summary of the testimony to the Committee states: "While many mining lands have, through the years, been forfeited to the Crown for non-payment of the acreage tax, there still remains considerable acreage of well-located but undeveloped and unproductive land."[26]

151. As stated earlier, the Province of Quebec, to prevent hoarding of mining lands and to expedite their exploration and development, in 1965 drastically

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[23]Royal Ontario Mining Commission, 1944, *Report*, Toronto: King's Printer, 1944.

[24]The Public Lands Investigation Committee, 1959, *Report*, Toronto: Queen's Printer, 1961, p. 4.

[25]*Ibid.*, p. 6.

[26]Select Committee on Mining of the Ontario Legislature, *Report*, Toronto: Queen's Printer, 1966, p. 34.

increased annual rentals on Crown lands and the annual tax on concessions granted under present legislation.

RECOMMENDATION

152. While no evidence was presented at our hearings that the hoarding of mining lands was a problem in Ontario, a specific instance of hoarding was brought to our attention when we visited certain mining companies in northern Ontario. Furthermore, it is clear that past inquiries directed specifically to mining were concerned with the necessity of structuring the acreage tax so as to discourage holding without exploration or development. As with timber rights, we believe that the level of the tenure charges should be such as to ensure optimum resource exploitation. This would in our view require a rate of at least 25¢ per acre, the rate recommended by the Select Committee on Mining of the Ontario Legislature. *We therefore recommend that:*

> ***The rate of acreage tax on mining lands be set and maintained at such level as is needed to perform the function of discouraging the holding of mining lands without the performance of adequate exploration, development or mining work.*** **32:17**

CROWN LEASES

153. Until 1963, it was the practice in Ontario when disposing of Crown land for mining purposes to grant to the holder of a mining claim who had met the conditions laid down in The Mining Act either a patent, which vested in him the Crown's title in the lands and all mines and minerals therein, or a lease, renewable in perpetuity. In 1959, the Government of Ontario appointed the Public Lands Investigation Committee to inquire into and make recommendations on the disposal of Crown lands under The Mining Act and The Public Lands Act, and their report was presented in 1961. Following this report, The Mining Act was amended in 1963 to provide that the holder of a mining claim would, in the first instance, be entitled only to a lease of his claim and would not be entitled to a patent until he was producing minerals in substantial quantities and production had been continuous for more than one year.

154. The Mining Act now provides that after September 1, 1963, a mining lease may be granted to the holder of a mining claim for a term of twenty-one years at an annual rental payable in advance of $1 per acre for the first year and 25¢ per acre for each subsequent year, with a minimum rental of $10 in the first year and $5 thereafter. If a lease of mining rights only is granted, the rental after the first year is reduced to 10¢ per acre with a minimum of $4. A lease is ordinarily renewable for further terms of twenty-one years, but the Minister may refuse to renew, may require the applicant to show cause why a renewal should be granted, or may refer an application for renewal to the Mining Commissioner for a hearing. A 1965 amendment to the Act provided for an annual rental in respect of licences of occupation of 25¢ per acre, with a minimum of $1, where such licences were issued without the provision of an annual rental.

155. The Select Committee on Mining of the Ontario Legislature in its 1966 report pointed out that mining lands can be held under lease for a period of twenty-one years without any requirement that the lessee perform additional exploration work—a situation contrary to most other jurisdictions in Canada, which require such work to be done on a regular basis throughout the lease period or, in lieu thereof, a cash payment to be made of equivalent value. The report states:

> The basis of this requirement is that in many situations additional work is desirable to assess better the merit of the property as a mineral producer.
>
> The additional work could sufficiently enhance the value of the property to encourage early production or, on the other hand, it could lead to discouragement and the disposing of the property either by sale or by forfeiture to the Crown. New owners with new ideas might locate hitherto undiscovered ore deposits.[27]

The Select Committee recommended that the duration of a mining lease be reduced to ten years from the present twenty-one years; that the rental after the first year be increased from 25¢ to $1.00 per acre for surface and mining rights, and from 10¢ to 25¢ per acre for mining rights only; that on each renewal of the lease the rental for surface rights remain at 75¢ per acre, but the rental for mining rights be increased by $1.00 per acre so that the rental would be $1.25 per acre during the first renewal, $2.25 per acre during the second renewal, and so on, to a maximum of $4.25 per acre; and that the rental increase for mining rights over 25¢ per acre be commuted where acceptable work has been performed, to be applied to the current year or any succeeding part of the term of the lease.

156. There is no doubt that the Select Committee was concerned with the necessity of structuring lease rentals so as to discourage the holding of leased lands without exploration or development. As with acreage taxes, we believe that the level of tenure charges should be such as to ensure the optimum utilization of Ontario's mineral resources. *We therefore recommend that:*

> ***Rentals on leased mining lands and mining rights be set on the basis and at the rates recommended by the Select Committee on Mining of the Ontario Legislature or at such higher level as is needed to perform the function of discouraging the holding of mining lands and rights without the performance of adequate exploration, development or mining work.*** 32:18

[27] *Ibid.*, pp. 32-3.

Chapter 33

Revenue from Forest Resources

INTRODUCTION

1. The statutes under which Ontario derives revenue from its forest resources include The Crown Timber Act, The Logging Tax Act, The Forestry Act, The Provincial Land Tax Act, and The Assessment Act. Of these Acts the last two, which apply to forests as one among many forms of land use, are singled out for treatment elsewhere in this Report. Concerning The Forestry Act, it suffices to note here that the revenue derived under this statute accrues from the sale of nursery stock, and should be considered subject to the principles developed in our treatment of provincial licences and fees. We are therefore concerned in this chapter entirely with the revenues that flow from The Crown Timber Act and The Logging Tax Act.

2. The amount of revenue the Province derives through The Crown Timber and Logging Tax Acts, about $16 million annually, accounts for little more than 1 per cent of net ordinary revenue. Table 33:1 offers a summary of the revenue in the years 1960-66 from the logging tax and the three principal levies authorized by The Crown Timber Act—stumpage, ground rent and fire-protection charges.

These sources, together with such miscellaneous items as recovered fire-fighting costs, constitute about 1.4 per cent of the annual value of Ontario forest production, and generally approximate the yearly cost to the government of protecting and managing the forests of Ontario.

3. While a comparison of forestry costs and revenues is of interest, we do not deem it particularly pertinent to our present purpose. The costs of forest protection are largely unavoidable; in any event, we do not believe that revenues

TABLE 33:1

PROVINCIAL FORESTRY REVENUES IN ONTARIO
1960–1966

Fiscal year	*Logging tax*	*Stumpage*	*Ground rent*	*Fire tax*	*Fire-fighting (cost recovery) and other*	*Total revenue*	*Percentage of net ordinary provincial revenue*	*Percentage of value of provincial forest production*	*Percentage of provincial forestry disbursements*
	(thousands of dollars)								
1960	1,624	10,381	82	1,058	314	13,459	1.92	1.34	103.42
1961	1,822	11,983	81	1,035	239	15,160	2.05	1.49	110.49
1962	2,094	12,202	83	1,085	199	15,663	1.90	1.49	99.20
1963	2,393	11,418	84	1,097	213	15,205	1.53	1.35	105.16
1964	3,175	12,195	81	989	274	16,714	1.55	1.43	101.26
1965	2,381	12,442	89	1,153	288	16,353	1.32	1.27	96.74
1966	2,257	13,770	84	1,083	263	17,457	1.21	N.A.	99.50

Source: Accounts Branch, Department of Lands and Forests, Ontario.

should necessarily be related to costs. Rather, the Province should so frame its policy as to obtain the best possible long-term return from its forest and other commercial resources, subject only to the limits imposed by such considerations of public interest as the need to preserve scenic beauty and recreation areas. Here it must be remembered that there are alternative uses for forest resources that may conflict with one another. For example, the good hunting and fishing on which a large part of the tourist industry relies must be weighed against the revenue potential of timber cutting and processing. It is with this qualification in mind that the question of what constitutes the best long-term revenue return from forest resources must be broached.

THE CROWN TIMBER ACT

4. In introducing a discussion of revenue under The Crown Timber Act, the legal situations that obtain with respect to mining and timber may be usefully distinguished. While in the case of mineral lands it has been customary for the Crown to grant title to both mineral rights and lands, title to timber lands has generally been retained by the Crown, the Province granting to operators only timber-cutting licences. Consequently there is no constitutional barrier to provincial royalties in respect of timber cut from Crown lands.

HISTORICAL BACKGROUND

5. Timber is an established source of revenue in Canada. As early as 1808, Lower Canada imposed a tax on scows and cribs of lumber and on square timber passing through the St. Lawrence Rapids between Chateauguay and Montreal. Timber licences were first put up for auction in 1827, launching at this time the continuing system of allowing competitive bidding to determine the return to government. Direct charges levied over and above licence fees as a means of assisting government to meet the cost of managing timber resources are similarly rooted in history. Thus the Province of Canada in 1851 enacted regulations imposing on all licensees an annual rental charge of 2s/6d per square mile.

6. In 1897 the Province of Ontario codified its several regulations concerning the sale of timber in The Crown Timber Act. The Act required those acquiring timber-cutting rights on Crown lands to pay to the Province a royalty based on the quantity and value of the timber cut. The amount payable per cord or per thousand feet board measure was to be determined with reference to the kind of timber and its location. This basic royalty or "stumpage" continues to the present. In 1917, The Crown Timber Act introduced an annual acreage tax to defray the costs of fire protection and fire-fighting services. Similar charges were imposed in 1925 by the first Railway Fire Charge Act on lands owned or leased by railway companies in Ontario. In the same year, the basic components of the present forestry revenue structure were rounded out when The Crown Timber Act provided for annual ground rent on all productive timberlands under licence in the province.

THE PRESENT REVENUE STRUCTURE

7. The Crown Timber Act authorizes the issuance of four types of cutting licences—order-in-council, sales, district cutting, and salvage. By far the most important is the order-in-council licence, which is granted by approval of the Lieutenant Governor in Council. This licence, which may extend for a period of up to twenty-one years, is the type normally issued to integrated cutting and processing enterprises. The areas covered by these licences are large and are normally capable, with proper forest management, of supplying a pulp or saw-mill in perpetuity. Order-in-council licences cover about 95 per cent of the area under licence in Ontario. Accounting for another 4 per cent of the area under licence, sales licences are of interest mainly to the independent cutting contractor. They usually involve small areas that are designed to be cut over a two- or three-year period. District cutting licences, for their part, apply to the lesser volumes of timber whose total estimated stumpage will not exceed $2,000. The issuing of district cutting licences is delegated to District Foresters, and because of varying conditions, their rates and terms differ from district to district. Salvage licences, finally, are granted for Crown timber that has been killed or damaged by fire, insect, disease or windfall.

8. Save for salvage licences, where charges and conditions are entirely discretionary, timber-cutting licences involve two basic types of charge, one for tenure, the other for severance, collectively known as Crown charges. The tenure charge itself comprises two elements, ground rent and a fire-protection charge, currently levied at the respective rates of $1 and $12.80 per year for each square mile of productive land under licence. The severance charge, properly known as stumpage, is made up of Crown dues and a bonus.

9. Crown dues are charges established by regulation for different species and represent the minimum stumpage. The complete set of Crown dues currently in effect is summarized in Table 33:2. These dues are expressed according to the several measures used by the industry—that is to say, board feet, cubic feet, and cords. The "bonus", if any, is obtained by means of an "upset price" which

TABLE 33:2

ONTARIO CROWN DUES, 1967

1. For saw-logs from timber of the following species, when measured in board feet:	
i. Ash, bass-wood, cherry, elm, maple, oak, or yellow birch, for each M f.b.m	$5.00
ii. Beech, poplar, white birch, or other hardwoods except those in sub-item i, for each M f.b.m.	1.50
iii. Balsam, jack pine, or spruce, for each M f.b.m.	4.00
iv. Cedar, hemlock, or tamarack, for each M f.b.m.	3.00
v. Red pine or white pine, for each M f.b.m.	5.00
2. For saw-logs or pulpwood from timber of the following species, when measured in cubic feet:	
i. Balsam, for each cubic foot	$0.0165
ii. Jack pine, for each cubic foot	0.0235
iii. Poplar or white birch, for each cubic foot	0.006
iv. Spruce, red pine or white pine, for each cubic foot	0.033
3. For pulpwood from timber of the following species, when measured in cords:	
i. Balsam or other conifers except jack pine and spruce, for each cord	$1.40
ii. Jack pine, for each cord	2.00
iii. Poplar or other hardwoods, for each cord	.50
iv. Spruce, for each cord	2.80
4. For boom timbers, piling or poles from any species of timber, in pieces containing:	
(a) Not more than 10 cubic feet, for each cubic foot	$0.03
(b) More than 10 cubic feet but not more than 20 cubic feet, for each cubic foot	0.04
(c) More than 20 cubic feet, but not more than 30 cubic feet, for each cubic foot	0.05
(d) More than 30 cubic feet, for each cubic foot	0.06
5. For fuel wood from any species of timber, for each cord	$0.50
6. For fence posts from any species of timber, for each lineal foot	$0.01
7. For railway cross-ties from any species of timber, each	$0.15

is normally supplemented through a competitive bid by the interested parties. The upset price is set for any prospective licence by the Department of Lands and Forests, and represents a conservative estimate on the basis of the appraised commercial value of the area, of the amount by which stumpage should exceed the Crown dues. The upset price accordingly constitutes the minimum bonus acceptable to the Department; the total amount of the actual bonus will be settled by negotiation or by competitive tender.

TENURE AND SEVERANCE CHARGES IN OTHER PROVINCES

10. Tenure charges, which are made up of ground rent and fire-protection levies, vary widely from province to province, as evidenced by Table 33:3. With the exception of minor pulpwood limits, there is no ground rent in Saskatchewan, where nearly all merchantable timber is marketed by a Crown corporation. In Manitoba different ground rents apply to pulpwood and timber limits at annual rates of $2 and $10 per square mile respectively. The Alberta ground rent for a timber limit is $30 per square mile annually; that in Quebec $10. The highest rates of ground rent are found in British Columbia, where rent differs with the location of the licensed area. Thus timber licences located west of the Cascade Range and hence close to tidewater carry an annual ground rent of $140 per square mile; whereas those east of the range bear a rent of $100. At $1.00 per square mile for a timber or pulp limit, Ontario's ground rent is among the lowest in Canada.

TABLE 33:3

TENURE CHARGES IN CANADIAN PROVINCES, 1964
(per square mile, except where otherwise indicated)

Province		*Ground rent*	*Fire-protection charges*
British Columbia	Timber	$100.00 or $140.00	$38.40
	Pulp	$50.00 or $70.00	$38.40
	Forest management licences	Various	9¢ per M f.b.m. of annual productive capacity
Alberta	Timber	$30.00	$12.80
	Pulp	As negotiated	$12.80
Saskatchewan	Timber	None	None
	Pulp	As negotiated	As negotiated
Manitoba	Timber	$10.00	Half the cost incurred by the province
	Pulp	$ 2.00	
Ontario	Timber and Pulp	$ 1.00	$12.80
Quebec	Timber	$10.00	None
	Pulp	None	None
New Brunswick	Timber and Pulp	$2.00 plus "mileage" of $0.02 per C cubic ft. of standing mature soft wood	$12.80
Nova Scotia	Timber and Pulp	If and as negotiated	¾¢ per acre on holding of 200 acres or more
Prince Edward Island	There is no Crown timberland in the province		
Newfoundland	Timber	None	None
	Pulp	$2.00	None

11. The fire-protection portion of tenure charges also reveals wide interprovincial variation. Timber licences in Saskatchewan are exempt from fire levies, as are all licences in Quebec, where the pulp and paper companies have formed their own fire-fighting associations. In Manitoba there is an annual assessment on each timber or pulp licensee of his pro-rata share, based upon the area of his licence, of fire-protection costs incurred by the province during the preceding year. The highest annual rate of fire charge is the $38.40 per square mile levied by British Columbia on both timber and pulpwood licensees. Ontario's $12.80 is identical to the Alberta and New Brunswick rates, and to the Saskatchewan levy on pulpwood licences. With respect to combined tenure charges for ground rent and fire protection, it is evident that these tend to move progressively upward west of Ontario, Saskatchewan excepted. Tenure charges, at $13.80 per square mile in Ontario, reach a high of $178.40 at the maximum rates levied by British Columbia.

12. If tenure charges tend to move upward west of Ontario, there is some evidence that severance charges display a reverse pattern, moving downward from east to west. Table 33:4 offers a summary of Crown dues, that is to say the minimum stumpage, applied by the several provinces to saw timber and pulpwood derived from the lowest- and highest-grade conifers. As a general rule there is a steady downward trend west of Ontario, whose Crown dues of $1.40 per cord for low-grade pulpwood, for example, contrast vividly with British Columbia's 25¢. True to this geographic pattern, Crown dues in Quebec and New Brunswick are, in turn, higher than in Ontario. To be sure, the data in the Table constitute but a rough approximation of reality in that only Saskatchewan, New Brunswick and Quebec[1] adhere in practice to their Crown dues schedules,

TABLE 33:4

CROWN DUES IN CANADIAN PROVINCES
ON LOWEST- AND HIGHEST-GRADE CONIFERS, 1964

	Saw timber ($ per M f.b.m.)		*Pulpwood* ($ per cord)	
	Lowest grade	*Highest grade*	*Lowest grade*	*Highest grade*
British Columbia	1.00	3.00	.25	.55
Alberta	1.75	1.75	.30	1.50
Saskatchewan	2.00	6.00	.75	1.40
Manitoba	2.50	7.50	1.25	2.45
Ontario	3.00	5.00	1.40	2.80
Quebec*	3.25	5.50	2.00	2.50
New Brunswick	7.50	9.00	2.75	4.10
Nova Scotia	As negotiated		2.00	2.00
Prince Edward Island†	N.A.	N.A.	N.A.	N.A.
Newfoundland	None	None	None	None

*Includes $0.15 per cord on pulpwood under Progress of Education Act. Note also that Quebec has a somewhat different method of board measure.
†N.A. Not applicable, as there are no Crown timberlands.

[1]The actual situation with respect to Crown dues in Quebec is somewhat complicated by the fact that this province has often made special arrangements yielding substantial initial payments on the granting of licences.

while the other provinces normally extract a bonus in addition to the dues. But it remains valid to point out that the Ontario system stresses stumpage over tenure charges to a greater extent than obtains in British Columbia, Alberta and Manitoba.

AN APPRAISAL OF STUMPAGE

13. When severance charges, or stumpage, are as important as they are in Ontario, a degree of analysis is in order particularly because stumpage has long been a subject of controversy. The argument in favour of stumpage is to the effect that this system enables the Crown to "sell" cutting rights through a method that approximates the market mechanism. Stumpage is simply the price the licensee pays as the outcome of a competitive bidding process. This seemingly strong argument notwithstanding, severe criticisms can and have been directed against the stumpage system. One of the most scathing attacks in recent years was mounted by the New Brunswick Forest Development Commission in its 1957 Report. A quotation from this Report (commonly known as the Bates Report) offers an excellent summary of the alleged defects of the stumpage system.[2]

> The present system of low annual carrying charges and high stumpage rates for Crown timber has many bad features which have been accentuated by gradual changes in the forest economy. It encourages the "high grading" of the forest: offers strong temptation for speculation in Crown timberlands; induces wasteful logging practices; and, above all, condones the holding of more Crown timber by some licensees than their present production warrants. At the same time, the system discourages the selective marketing of the many varied forms of timber, and effectively dampens any wish a Crown tenant might have to improve the timber resources allotted to him. The system calls for a great deal of work in scaling and bookkeeping which adds nothing to the intrinsic worth of the product, but materially raises the overhead costs of both the Department and the licensees. It holds no inherent incentive for increased production, indeed it actually deters investment aimed at great output. Despite what the regulations say, the policy divides responsibility for forest management in an impracticable way.

Let us proceed to consider each of these criticisms in the context of the Ontario stumpage system.

14. The first criticism is that stumpage encourages high-grading. High-grading in forestry is the process of removing the more valuable trees, usually the conifers, and leaving behind the hardwood species, particularly birch and poplar. The theory is that if the dues for Crown timberlands took the form of a fixed annual charge such as a rent, no particular tax would attach to any one class of trees. Thus the less-popular species would be regarded as being free of stumpage and accordingly would be logged to a greater extent. In practice, while hardwood species are not logged to any great extent in Ontario, we have found no evidence to link this with the system of stumpage charges. The principal reasons why hardwoods are not cut are that hardwood logs cannot be easily floated to the

[2]New Brunswick Forest Development Commission, *Report*, Fredericton, 1957, pp. 105-6.

mills, as conifers can, and that markets for hardwood products are limited. In fact, hardwood trees are generally not logged to any greater extent on private lands than on Crown lands.

15. Secondly, it is alleged that stumpage induces wasteful logging practices. Less-accessible trees and the wood at the base or top of a tree have lower value. Hence the operator will not consider them worth the stumpage incurred in removing them from the forest. The presumption underlying this charge is that there is always a choice of logging in some other place where stumpage represents a relatively lower proportion of value. In practice, however, the costs of frequently moving men, camps and machinery to more favourable locations will normally exceed any differential in the relative stumpage burden. Moreover, in any given instance, the costing of woods operations is not sufficiently precise to determine whether stumpage makes it uneconomical to log a particular segment of the area chosen for the annual cut or to remove less than the whole tree. Furthermore, in the specific context of Ontario, the Department of Lands and Forests must approve an operator's annual cutting plan, and imposes penalties on wasteful practices. Thus the charge that stumpage encourages wasteful practices has little validity in this province.

16. Next, it is said that stumpage dampens the licensee's desire to improve his timber resources and deters subsequent investment aimed at increasing output. In both New Brunswick and Ontario at the time of the Bates Report, this criticism had a good deal of force. The problem raised by the stumpage system is that it applies not only to the timber standing on the licensed area when the licence is first granted but to the second and all succeeding crops. It is generally accepted that the best form of forestry management—in easily accessible areas, at least—is one designed to produce a sustained yield. This means that, taking the licensed area as a unit, cutting should be regulated so that the annual average cut is balanced with the new forest growth. However, the implementation of such a plan of management requires careful attention to regeneration, which involves considerable expense. The licensee is naturally unwilling to incur this expense if he is also obliged to pay the normal rates of stumpage when he removes his crop. Thus, while it is of benefit to the forest industry as a whole to pursue a policy of sustained yield management and regeneration, the stumpage system tends to discourage an individual operator from adopting this policy. As the Bates Report points out, the system "divides responsibility of forest management in an impracticable way".

17. This problem does not now appear to be a pressing one in Ontario because the province has accepted over-all responsibility for forest regeneration. The Department of Lands and Forests now enters into contracts with licensees under which the latter carry out a planting program at an agreed price. Alternatively, the Department will carry out such a program using its own crews. Further, it is a long-standing policy of the Department to require licensees to carry out their logging programs in accordance with a management plan approved by the Department before logging commences. This plan is reviewed annually.

Thus, while there is validity to the criticism that the stumpage system in itself tends to discourage forest regeneration, this tendency appears to be overcome in Ontario by a planned regeneration program.

18. Again, it is said that the stumpage system offers strong temptation for speculation in Crown timberlands, and that it condones holding of excessive tracts of timber. Both of these criticisms are no doubt based on the ground that, since no charge is made for the timber until it is cut, a licensee in effect has a free option on all uncut timber, subject only to ground rent and protection charges. These criticisms appear to be valid and may have been particularly so in New Brunswick where there are considerable stands of over-mature timber. The holding of timber beyond maturity represents an economic loss since over-mature stands do not produce any new net forest growth and may be a reservoir for disease. A variation of the problem does exist in Ontario, namely the holding of extremely large tracts of timberland by single corporations, so that other operators are precluded from carrying on forestry that might otherwise take place. Following the presentation of the Bates Report, the stumpage system in New Brunswick was modified to replace a part of the stumpage by a fee based on the annual inventory of softwood in the licensed area. This was clearly directed at reducing the over-mature stands which would constitute an important part of any inventory. In Ontario, something of the same problem may exist although it must be remembered that markets are not available for anything approaching the annual allowable cut.

19. The final criticism—that stumpage calls for a great deal of work in scaling and bookkeeping that adds nothing to the worth of the product but raises the overhead costs of the government and the licensee—is most apt. Information from the Department of Lands and Forests indicates that in recent times the cost of establishing the annual stumpage approaches 10 per cent of the revenue collected. This represents an amount in the range of $1 million annually to which must be added the administrative costs of billing licensees. Changing methods of production and some new developments in scaling methods are, however, bringing about changes. In place of scaling, a method known as "cruising" is now used on occasion. This involves estimating the volume of wood in an area to be logged before the logging takes place and basing the stumpage dues on this estimated volume rather than the actual volume measured after the cut. Here is a field in which statistical methods would be useful, and if the Province and the licensee are both prepared to accept a scientific basis of estimating rather than an actual calculation, substantial reductions in the present costs of scaling could be expected.

20. In summary, it would seem that of the various criticisms which have been raised against the stumpage system, the most valid are that it encourages the holding of over-mature stands and excessively large tracts of timber, and that it is a costly method of raising revenue. These criticisms justify examining other revenue-raising methods and their effects on forestry management.

ALTERNATIVE REVENUE-RAISING METHODS

21. The alternatives to stumpage as a means of raising revenue from forest resources must be sought either in the realm of profits taxation or in that of tenure charges. Tenure charges, in turn, can involve rentals based alternatively on stumpage appraisal, inventory, area or productivity. We shall now proceed to assess in order the profits tax and each of the four possible forms of tenure charges.

A PROFITS TAX

22. The possibility of deriving forest revenue from a profits tax has a dual attraction. The first is that, as it applies specifically to the forest industry, a profits tax may encourage fuller exploitation of marginal timber limits. The second is that since a profits tax applies to mineral resources, there is virtue in extending it to forests, thereby securing similar treatment of both these natural resources. We frankly consider both advantages highly superficial.

23. We are sceptical about whether a profits tax can exert any real influence on the exploitation of marginal limits. Such exploitation in any event will not normally be undertaken if there is little or no chance of profit, and the degree of chance can generally be determined in advance since the forest industry, in sharp contrast to mining, is neither unusually volatile nor risky. Thus the advantage of a profits tax over tenure charges in the matter of marginal limits, if any, will tend to be slim.

24. The supposed virtue of securing uniform treatment of natural resources by extending the profits tax from mining to forestry escapes us altogether. While mines and forests are indeed natural resources, they involve quite different methods of exploitation and very different degrees of risk. Moreover the legal situation with respect to each recommends dissimilar revenue approaches. A fundamental reason for applying profits taxation to mining is that the Province has, in most instances, parted with the fee simple in mineral lands and hence is constitutionally unable to impose a valid form of royalty or tax on gross production. Such inflexibility does not plague the forestry revenue system because the Province has retained ownership of the greater part of its forests.

25. From the standpoint of provincial revenue, a profits tax is less likely in practice to produce a maximum return to the Province than a tax or royalty based on gross income. Since the person who exploits a natural resource, like any other businessman, essentially seeks a return on the capital he invests, the balance of the total profit derived from the resource is the potential economic rent or price of exploitation. Thus when the operator's stipulated return on capital has been covered, the amount he will be prepared to pay under perfectly competitive conditions to the owner of the resource—in this case the Province—will, if expressed as a tax on the excess profit, approach 100 per cent. Even under less than perfect competition, the return to the Province may potentially approach 100 per cent. However sound in theory, the emotional and administrative problems of imposing a 100 per cent excess profits tax are such as to

place it beyond the realm of practical consideration. The Province is accordingly more likely to recover its due economic rent through a negotiated or competitively determined charge than through a rigid excess profits tax. Whether in terms of forest management, revenue structure, or revenue yield, we find no reason to favour a system of profits taxation with respect to forest resources.

RENTAL BASED ON STUMPAGE

26. Under this form of tenure charge, the quantity and value of the timber in each licensed area are estimated and the operator is assessed an annual fee equal to a portion of the profit that a normally efficient producer would obtain. Rental based on stumpage appraisal obtains in British Columbia, where it is calculated on the basis of estimated market values at Vancouver with appropriate adjustments for transportation. In theory, stumpage appraisal is likely to yield to the Province a substantial portion of the full economic rent of a timber limit, but it is subject to strong practical objections, especially in Ontario. The method assumes that a normal profit can indeed be determined, but this will be extremely difficult unless there is an open market establishing prices that can be applied to the whole forest area. Since the situation with respect to markets for Ontario forest products is highly complex, the process of normal profit determination would be plagued by serious problems. Such problems, moreover, would only be rendered more acute by the fact that the number of trained appraisers needed to adapt the system to Ontario far exceeds the foreseeable supply. Again given the complexity of the market situation, stumpage appraisal would likely impose on Ontario forest operators a greater degree of financial inspection and red tape than we would care to recommend. On balance, then, practical considerations would seem to preclude a stumpage appraisal system for Ontario.

RENTAL BASED ON INVENTORY

27. The inventory approach has been adopted as part of the New Brunswick system of tenure charges. Here the volume of timber on hand in a licensed area is estimated each year, and an assessment made on this volume. As a revenue-raising method, the inventory approach appears to be as time-consuming and costly as any but it has the advantage — important for New Brunswick — of placing a premium on over-mature stands of timber. This very advantage, however, becomes a source of inequity for any holder of extensive stands containing a high ratio of immature timber. We have seen evidence to the effect that in order to sustain similar output, one operator may need twice the inventory required by another. Hence the importance that the inventory method attaches to maturity makes it too one-sided a system to be appropriate in Ontario.

RENTAL BASED ON AREA

28. This form of tenure charge is currently in force in Ontario at the relatively low rates discussed earlier in this chapter. The Bates Report recommended a prominent role for the area method in New Brunswick, and its general application has been advocated by a well-known independent study of forest revenues

in Canada.[3] The advantages of basing forest revenues on area charges are that the system is administratively simple and inexpensive, and that it is economically neutral, allowing the operator to base his cutting decisions on straightforward business criteria. Among the Canadian provinces, British Columbia places the greatest emphasis on area charges, and the fact that this province is a major wood-producer testifies to the practicality of the system. But for all its practicality, an area basis, like the inventory method, has its inequities. Thus it ignores the quality and density of a timber stand, and thereby may also ignore maturity. In so far as the evidence before us shows that there exist wide variations in potential annual yield per square mile, we hold the opinion that reliance on area charges must be limited. In theory, the inequities arising from heavy reliance on an area system could be minimized if the charges were geared to the volume of timber that the area could reasonably be expected to yield over the long run. But fluctuations in demand, the impact of new product discoveries, actual rates of forest growth, and the effect on that growth of logging operations all make this possibility highly unlikely.

RENTAL BASED ON ANNUAL ALLOWABLE CUT

29. This final method finds its basis in the productive capacity of a timber limit as measured by the Crown's calculation of the annual allowable cut of each species within the limit. Since the Department of Lands and Forests already makes calculations of annual allowable cut for forest management purposes, this method involves no new administrative procedures. And for reasons which we shall outline below, we consider this method the one most suitable to the determination of tenure charges in Ontario.

A REVISED SYSTEM OF CROWN CHARGES FOR ONTARIO

SHIFTING AND INCIDENCE

30. Before broaching the merits of the specific changes we advocate a few remarks concerning the shifting and incidence of forestry revenues are in order. Crown charges—that is to say, severance (stumpage) and tenure charges—are variable costs to the companies that cut logs from their licensed limits on Crown timberlands. Given reasonably buoyant demand for labour in Ontario, together with the fact that in competing for labour, the forestry industry is at a disadvantage vis-à-vis other employers because of its remote location, it is unlikely that increases in the variable costs of timber operations will tend to be shifted backward to wages.

31. As to the possibility that timber operators might shift changes in variable costs forward to their purchasers, we may distinguish among purchasers of lumber, newsprint and other pulp and paper products. With respect to lumber the situation is one where, as a general proposition, the output of other provinces constitutes most of the total market supply. The market price for lumber may thus be taken as given, and any shifting forward of increased variable costs due to higher Ontario Crown charges is therefore unlikely. The newsprint industry,

[3] A. Milton Moore, *Forestry Tenures and Taxes in Canada*, Toronto: Canadian Tax Foundation, 1957.

meanwhile, is an international oligopoly where experience indicates that only substantial long-run changes in the costs of Canadian and Ontario producers will affect price. Since their impact on total variable costs is slight, Crown charges are not likely to be shifted. As to other pulp and paper products, chemical pulps are produced and sold under economic circumstances broadly similar to those that obtain in newsprint. Paperboards and fine papers, for their part, constitute a tariff-protected Canadian oligopoly. Here, increases in costs would be subject to forward shifting if they were incurred by all the sellers in a particular market, but the ability of Ontario producers to shift forward cost increases suffered by them alone would be tightly circumscribed. In sum, it would appear that the costs of Ontario forest operations are not readily subject to forward shifting, whether in regard to lumber, newsprint or other pulp and paper products.

PROPOSED TENURE AND SEVERANCE CHARGES

32. Under circumstances where the ability of Ontario timber operators to shift changes in variable costs backward to wages or forward to purchasers is severely limited, changes in Crown charges will be borne largely by them alone and can be expected to affect their economic incentives. As between tenure and severance charges, the present Ontario system places very heavy emphasis on the latter. We have pointed out that severance charges, or stumpage, can encourage the holding of over-mature stands and excessively large tracts of timber. A Crown charge system that placed lesser reliance on stumpage and increased emphasis on tenure charges could be expected to induce desirable changes in the conduct of timber operations.

33. There are concrete indications that operators now hold licensed areas greater than their reasonable requirements warrant. Indeed, our studies show that major licensees in Ontario hold, on the average, limits capable of yielding twice their present annual requirements. Given the uncertainty of his market and the long growth cycle of his forest, a licensee may rightly be expected to hold limits somewhat in excess of his current requirements. We suggest, however, that the present size of limits is on the average much in excess of the area that would seem to be dictated by normal economic prudence. We note that under the existing tenure system, the combined ground rent and fire-protection charges of $13.80 per year must accumulate for over one hundred years at six per cent annually before they equal as little as 10 per cent of the current cost of producing a cord of wood. Further testimony to the inconsequential burden of these charges can be seen in that no operator in recent times has surrendered any part of his limits because of overly burdensome carrying charges.

34. In this setting, a Crown charge system that places greater reliance on tenure appears to us highly desirable. And among the different types of tenure charge available, that based on a licensee's annual allowable cut is to be preferred. This basis has a clear advantage over the area and inventory methods in that it avoids the inequities the latter create by ignoring the quality, density and maturity of timber stands. The annual allowable cut as calculated by the Department of Lands and Forests corresponds precisely to the amount of marketable

timber which each limit should properly yield in a year, and hence takes into account the peculiarities of each licensee's holdings. If a tenure charge based on annual allowable cut is set at a sufficiently high rate, it will create an incentive for the operator to cut precisely that amount of timber which good forest management warrants, or alternately discourage him from holding excessive limits, which then become available for other operators or may revert to Crown management.

35. We have devoted considerable thought to what might be an appropriate level of tenure charges on the basis of annual allowable cut. Our studies indicate that such charges would necessarily have to differentiate between conifers and hardwoods. Because supply greatly exceeds demand, a lesser charge is warranted for hardwoods. Our inquiries disclose that while major operators collectively cut approximately half the allowable quantity of coniferous timber, they cut only about one-sixth the allowable quantity of hardwoods. This, together with the fact that hardwoods and conifers are normally intermixed within a licensed area, indicates that the tenure charge on conifers might equitably be related to the tenure charge on hardwoods in the ratio of three to one. A tenure charge of 1.5¢ per cubic foot of allowable cut for merchantable conifers and of 0.5¢ per cubic foot of allowable cut for hardwoods would yield to the Province approximately $100 per usable square mile of licensed area. This amount remains below comparable yields per square mile in British Columbia and New Brunswick by an amount that approximately corresponds to the proportionally lower productivity of Ontario timber limits. The exact amount of tenure charges might be set by the Department of Lands and Forests after further study consistent with the above principles. Accordingly, *we recommend that:*

The present ground rent and fire-protection charges on Crown lands be abolished and replaced by tenure charges fixed at rates per foot of allowable cut based on sound principles and on further study by the Department of Lands and Forests. **33:1**

36. Acceptance of the system of tenure charges recommended above will make possible a substantial reduction in the severance portion of Crown charges. We do not believe, however, that stumpage should be eliminated altogether, for two reasons. First, the bonus element of stumpage, as a price set by tender or negotiation, reflects on a competitive basis the advantages of one timber licence area over another. Second, stumpage is a desirable supplement to tenure charges in that it permits some sharing of risk between the timber operator and the Province. We deem it appropriate for the landlord to share with his tenant some part of the risk that arises with respect to fire, changes in demand, and the like.

37. The bonus portion of severance charges should continue, as at present, to be determined by what approximates market forces. As to the minimum stumpage, or Crown dues, we recognize that the more onerous tenure charges recommended here will necessitate downward adjustment. The principal rationale for our proposed tenure charge system is to encourage the licence holder to cut

his limits in conformity with the principles of good forest management. It follows that Crown dues should be set in such a manner as to lend support to the objectives of the tenure charge system. We believe that this could be served best by a schedule of Crown dues so designed that, in any given year, the combined burden of tenure charges and Crown dues on an operator would not exceed his present burden, provided his actual cut was equal to his allowable cut. This, of necessity, means that an operator's burden will be increased in terms of cost per cubic foot cut if he should cut less than his annual allowable cut, thereby increasing his incentive to cut in keeping with good forest management. *We therefore recommend that:*

> ***The Department of Lands and Forests make appropriate adjustments in the rates of Crown dues so that combined tenure charges and Crown dues per cubic foot cut by a licensee, whose actual cut is equal to his allowable cut, will approximate the amount of such combined charges under present rates.*** **33:2**

38. It may be that there are exceptional instances where the implementation of a revised system of Crown charges should recognize the fact that provincial responsibility for the planned reforestation of licensed limits has been in existence for a relatively short time. Under such circumstances, it may be reasonable to take account of cases where an operator's expenditures to protect the standing forest and bring new growth over, say, the past two decades exceed the tenure charges that would have been collected had the new rates prevailed during that period. We have no knowledge of any such instances, but suggest that if there are any, the Department of Lands and Forests consider whether the circumstances warrant a provision in the legislation for appropriate relief.

39. There remain in Ontario a number of forest areas that are privately owned and hence are not liable for Crown charges. These cover approximately one-tenth of Ontario's northern forest land, and are subject only to the provincial land tax discussed elsewhere in this Report. While we do not think that private forest lands, any more than agricultural lands, should be subject to a special tax, we believe that the amount paid by their owners for fire protection should not be less than the cost to the Province of providing that service. Since our studies indicate that fire-protection charges may not now generally cover the costs to the Province, *we recommend that:*

> ***With respect to privately owned forest land, fire-protection charges be reviewed and set on a cost-recovery basis.*** **33:3**

THE LOGGING TAX ACT

HISTORICAL BACKGROUND

40. The Logging Tax Act was introduced in Ontario in 1950 as a marginal revenue measure. Levied at an initial rate of 9 per cent of profits from woods operations, the tax was extended in 1957 to cover profits from processing. In

1961, the tax ceased to have an impact on logging companies in the wake of a federal-provincial arrangement that permitted these companies a full credit against their federal and provincial corporation income taxes. Pursuant to this arrangement, the logging tax rate was raised to a level of 10 per cent in 1963, and currently yields the Province somewhat more than $3 million annually. Among the Canadian provinces, British Columbia and Quebec also levy logging taxes, introduced in the latter province in 1963 solely to take advantage of the federal credit.

TAX BASE AND TAX CREDIT

41. The logging tax is imposed on income in excess of $10,000 derived during the year from "logging operations". Income derived from logging operations is defined by the Act to mean "value of the logs disposed of", less the total cost to the taxpayer of the acquisition of standing timber, the acquisition of the right to cut standing timber or the acquisition of logs, and the importation of logs or the transportation of logs. The costs of these operations must not include any amounts withdrawn as salary or other forms of remuneration by any partner or member of a syndicate or by an individual if any of these persons is liable to pay logging taxes.

42. "Value of logs disposed of" means the proceeds from sale of standing timber, cut logs or the right to cut standing timber, whether on a royalty or stumpage basis. If the logs are delivered to a processing plant that is operated by the taxpayer, the value of logs disposed of is the sale value of the finished product at the taxpayer's plant, less:

(1) The cost of processing the logs, including capital cost allowances, but excluding salary or other remuneration paid to a member of a partnership or syndicate or to an individual, where any of these persons is a taxpayer;

(2) The cost of transporting, by a common carrier, cut logs from the logging site to the plant where they will be processed; and

(3) An allowance of 8 per cent of the capital used in processing operations.

43. The processing allowance of 8 per cent of capital used must not be greater than 65 per cent nor less than 35 per cent of the taxpayer's income from all sources as defined by The Corporations Tax Act but excluding investment income, income from a business involving neither logging nor log-processing, and the net profit derived from selling standing timber, selling the right to cut standing timber, or selling logs. The processing allowance, together with its limitations of 65 per cent and 35 per cent is, so far as we have been able to determine, completely arbitrary. If the logging tax were retained, we would recommend that the existing processing allowance be reviewed.

44. But the existing tax credit arrangement raises in our minds considerable doubt about the advisability of retaining the logging tax. As a result of intergovernmental negotiation, the Dominion currently allows against federal income taxes otherwise payable a credit of the lesser of two-thirds of the logging taxes

paid to Ontario or one-fifteenth of the logging income earned in Ontario. The Province, for its part, allows a credit of one-third of the logging tax against Ontario corporation taxes. The result of these two credits is to relieve the logging companies of the burden of the logging tax except in the circumstances set out in the following paragraph. The Province, in effect, forgoes one-third of the logging tax revenue by reason of the credit which it allows on its corporation tax. But in that the remaining two-thirds of its logging tax revenue is allowed as a full credit against federal taxes, this portion represents in effect a payment from the federal government. This payment is justified on the ground that provincial expenditure on forestry justifies special revenue from logging operations.

45. A logging company is deprived of any relief for the logging tax in any year where under the Income Tax Act (Canada) and The Corporations Tax Act (Ontario) it has no taxable income because of the deduction in that year of a loss sustained in the following year or in the five preceding years. In our view similar loss-carry-over provisions should be enacted in The Logging Tax Act, so that the logging company would be relieved of paying the logging tax in any year that it was not liable for income taxes because of losses incurred in other years.

46. In principle, additional provincial revenue from logging through such devices as the logging tax and its accompanying credit arrangement is justified only if the Province is in fact deriving less than fair economic rent from its system of Crown charges. This situation may obtain in that the existence of federal taxes will reduce the amount which the timber operator retains to cover his return on capital and rental payment to the Province. The present credit system, which absorbs the entire burden of the logging tax on the operator while producing a transfer of funds from the federal to the provincial government is evidently based on this premise. But if a transfer of federal funds is indeed warranted under the circumstances, we believe that it can preferably be effected as a straightforward payment rather than as the tortuous outcome of arrangements for recouping a tax which then is in effect not a burden on the operations on which it is levied. *We therefore recommend that:*

> ***In the negotiation of general federal-provincial fiscal agreements, Ontario offer to repeal The Logging Tax Act in return for an additional share of income taxes imposed upon taxpayers engaged in logging that approximates the present net return to Ontario from the existing logging tax arrangement, and, pending such repeal, The Logging Tax Act be amended by the enactment of loss-carry-over provisions similar to those included in the federal Income Tax Act and The Corporations Tax Act of Ontario.*** **33:4**

Chapter 34

Revenue from Other Natural Resources

1. No survey of the revenues derived from the exploitation of the natural resources of the province would be complete if it were limited to mining and forestry. Though smaller in total than either of those two sources, a variety of revenues accrues from levies upon producers of natural gas and oil, from hunters, trappers and fishermen, and from users of water power for the purpose of generating electricity. This chapter is devoted to a brief discussion of these revenues.

PRODUCTION OF NATURAL GAS

2. The natural gas wells of southern Ontario have been producing a modest quantity of gas for many years. In 1965 the total production was 12,699,483 M.c.f. (thousand cubic feet) with a wellhead value of $4,820,740. Production figures vary from year to year: a high of 15,920,005 M.c.f. was reached in 1963.

3. Revenue derived by the Province from this production has, in the four years ending March 31, 1965, averaged over $370,000 annually. In addition, a small amount is received for licences that permit exploration for gas and oil on property under the Great Lakes. In effect, all producers whose annual output

exceeds 50,000 M.c.f. are subject to a tax under The Mining Tax Act whether their properties are freehold or held under Crown lease. With the latter type of holding, the Province receives an annual rental or a royalty on the actual production in addition to the tax under The Mining Tax Act. The rates vary according to whether the properties are on- or off-shore, but at present all producing wells on Crown lands are located under Lake Erie and Lake St. Clair. Where the mineral rights are owned privately, as they happen to be for all wells on land, only the tax is imposed. We shall discuss this tax first.

THE MINING TAX ACT

4. Under the provisions of this statute, the Province imposes a levy of 2¢ per M.c.f. on gas produced in Ontario and exported, and ½¢ per M.c.f. on gas produced and consumed in Ontario. As a practical matter, no domestically produced gas is exported and the only rate used is ½¢ per M.c.f. We regard this as a fortunate circumstance, for in our view the existing statutory differentiation is in principle entirely unwarranted. A provision of the statute permits the government to forgo tax up to an amount of $250 as a matter of ministerial discretion, and this is always applied. The effect is that of taxing a producer on only that part of his production that exceeds 50,000 M.c.f. Undoubtedly the result is to reduce administrative problems greatly, since in 1965 only 16 of the 130 operators produced more than 50,000 M.c.f. In the year ended March 31, 1965, the yield of the tax was slightly over $41,000.

5. Following the reasoning of the Caledonian Collieries case[1] it seems clear that the tax in its present form is *ultra vires* the Province, since it must be construed as an indirect tax. That it has never been challenged in the courts probably results from the realization that a constitutionally valid tax of at least the same weight would be enacted if the decision went against the Crown. Even though a royalty may be considerably easier to administer than a tax on profits, we cannot support what appears to be a constitutionally invalid levy.

6. The principle justifying a tax on the extraction of other minerals—namely, to appropriate to the public treasury some part of the economic rent (excess returns) accruing to the private developer of the natural resource—applies with equal force to the production of natural gas. The work that we have done and the operational data available to us have not been sufficient to enable us to propose any detailed structure of such a profits tax. It may be, for example, that some minimum exemption will be justified on administrative grounds. Administrative considerations may also make it desirable to levy a tax on profits with a proviso that the tax may not exceed a specified percentage of the wellhead value of production. This would then permit the Province to compute the tax on a production basis, in any situation where accounting records were either unreliable or nonexistent. At any rate, we are convinced that the form of the tax should be changed to a constitutionally valid profits-based tax without any differential rate as between domestically marketed and exported gas. Moreover, we think that the effect of

[1]*The King v. Caledonian Collieries Ltd.* (1928) A. C. 358.

such a tax should coincide with that which we have sought from our proposals in our chapter on revenues from mines: i.e., to tax the economic rent accruing from the production of natural gas at a rate of approximately 12 per cent. *We therefore recommend that:*

In accordance with the general principles that we have developed for the taxation of mines, the tax on production of natural gas be changed to a uniform Yat-rate profits-based tax, equivalent to 12 per cent of the economic rent accruing to the producer. 34:1

LEASE RENTALS AND ROYALTIES

7. All rights to off-shore gas are owned by the Crown, putting the Province in an entirely different position vis à vis the producers on the lakes from that which it occupies vis à vis those on privately owned land. Those who explore underwater areas are first required to take out a licence of occupation. If gas or oil is found in commercial quantities, the licensee may then enter into a lease arrangement with the government in respect to the property. The rental is $1 per acre, with a minimum charge of $640. In 1965 there were fourteen firms holding leases, of which only nine were actually producing gas and one oil. The total rental charges from leases in the 1965 fiscal year amounted to approximately $184,000.

8. When gas is produced from off-shore wells it becomes subject to a royalty which must be paid to the Province. This royalty is calculated as 10 per cent of the value of production based on the prevailing field price for natural gas, less the amount of rental paid on the lease. These payments are in addition to the tax under The Mining Tax Act which is applicable on any production over 50,000 M.c.f. annually. In the five years to March 31, 1966, gas royalties have averaged over $78,000.

9. The principle of leasing rights for a fixed rental or any greater royalty on production seems to us quite appropriate, and we see no reason for recommending any changes in the present leasing arrangements. The Province is clearly entitled to receive such a payment from the leaseholder, in addition to assessing a tax under The Mining Tax Act on production from Crown lands. However, the royalty under existing leases has no doubt been established at a higher level than would have obtained if a more realistic rate of tax than ½¢ per M.c.f had been imposed under The Mining Tax Act. The combined weight of the lease rental or royalty plus the profits-based tax that we propose would therefore be unjust unless some downward adjustment were to be made. As we do not favour altering the contractual terms of the leases, we suggest that relief should be given by allowing a deduction from the tax in respect of the lease rentals and royalties paid to the Province. On the basis of present prices, a deduction equivalent to 75 per cent of the lease rentals and royalties would leave profitable lessees in the position of incurring an over-all

cost of approximately 1¢ per M.c.f. greater than if their production were from freehold lands. We think that this differential is reasonable. Therefore, *we recommend that:*

The proposed profits-based tax on a producer of natural gas be reduced by an amount equivalent to 75 per cent of the rentals or royalties payable under leases from the Province of the lands from which the production is derived. **34:2**

OIL PRODUCTION

10. Oil production in Ontario, though still small, has tripled between 1954 (412,474 barrels) and 1965 (1,279,162 barrels). In the latter year, the value of oil production was approximately $3,693,000. There are more than seventy producers in the province, with annual outputs varying from less than thirty barrels to more than 500,000 barrels. In 1965 only nine operators had production in excess of 20,000 barrels. One producer operates an off-shore lease and so is subject to lease and royalty payments; the others operate on privately owned mineral rights on land.

11. There is no specific tax or levy on oil production or on the profits therefrom, except for the royalty on production from Crown leases. The revenue potential is undoubtedly small, and the administrative costs of taxing small producers probably would be relatively high. Notwithstanding these objections, we consider that oil, like any other natural resource, should yield an appropriate return to the Province when it is exploited, although an exemption for the very small producers may be justified on administrative grounds. The principles we outlined for the taxation of other minerals apply with equal force to oil. The proposals we have made with respect to taxation of the producers of natural gas should also apply to producers of oil, with relief in respect of lease rentals and royalties to operators on Crown lands. Accordingly, *we recommend that:*

A tax be introduced on the profits derived from oil production on the same basis, at the same rate and with the same relief to operators on Crown lands as recommended for natural gas production. **34:3**

WATER POWER RENTALS

12. The discovery of techniques for using waterfalls to generate electricity gave new value to a resource that until then had been prized mostly for its beauty. Even before the turn of the century, when proposals were made to tap the vast power of the Niagara River for generating electricity, the provincial government had asserted its right to regulate and levy charges for the use of water for this purpose. The power rights are conferred by formal agreements between the Province and the developers, setting out the charges and conditions. Such agreements between the Province and public and private users of water power at present yield a total annual revenue well in excess of $5 million, and are expected to return $6 million in the 1967 fiscal year.

13. Water power agreements can be grouped into two categories: those with The Hydro-Electric Power Commission of Ontario and those with private users. The first class is by far the more important since Hydro, with an installed capacity of over 6,750,000 horsepower, generates 90 per cent of all the hydro-electric power produced in the province. Many separate agreements with Hydro were consolidated in 1959 into three new master agreements, one covering the St. Lawrence River, a second the Niagara and Welland Rivers and their tributaries, a third covering all other waters. Under the terms of the agreements, Hydro is required to pay a basic rate of $1.35 per year for each annual horsepower generated. This basic rate is modified annually on the basis of changes in the consumer price index. The current adjusted rate is $1.60, and save for a few exceptions provided in the agreements, Hydro is now paying this rate to the Treasurer of Ontario for its water power.

14. The second class of agreements, those with private power producers, which at present number twenty-seven, vary greatly in duration and terms. The periods covered by the agreements range from five to forty years, and although most of the annual rates are between $1.50 and $2.00, some are as low as 75¢ per average horsepower. The agreements yield approximately $600,000 annually, about one-tenth the amount received from the agreements with Hydro.

15. A number of the rental contracts with private power producers will require renewal in the next few years. It is the government's present policy to rewrite the terms of these agreements so that they parallel those in the Hydro agreements, applying a basic rate that will vary with changes in the consumer price index. The basic rate of $1.85, at 1963 price levels, was chosen as being most representative of the existing rates.

SYSTEMS OF OTHER PROVINCES

16. Although most provinces regulate the generation and distribution of electricity, 84 per cent of Canada's total production is now concentrated in Ontario, Quebec and British Columbia. The same three provinces produce an even greater proportion (90 per cent) of hydro-electric (water-generated) power in the country: in 1963 Ontario generated 28 per cent, Quebec 48 per cent and British Columbia 14 per cent.[2]

17. British Columbia reports in its Public Accounts a revenue in the year ending March 31, 1965, of $2,182,320 from water rentals and recording fees. Quebec, on the other hand, lists a number of items related to water power, of which the most significant are $2,374,000 from water power rentals and royalties, $2,367,000 from royalties on electric power generated, and $19,214,000 from a levy on the Hydro-Electric Commission based on the amount of power generated—a device which that province uses to derive revenue from ownership of this large electric utility. It is apparent that none of the major power-producing provinces derives a large amount of revenue from water rentals *per se*, although the levy on generated power in Quebec does return a substantial amount.

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[2]Dominion Bureau of Statistics, *Electric Power Statistics, 1963.*

ECONOMIC CONSIDERATIONS

18. We considered and soon rejected the proposition that an appropriate level of charges for water power rentals would be their opportunity cost—the revenue that might have been raised if the water had been put to its best alternative use. Doubtless Ontario's waters are becoming increasingly valuable for such purposes as transportation, irrigation, recreation, conservation and domestic and commercial consumption. It cannot be said, however, that the use of water for hydro power inevitably detracts from its usefulness for these other purposes. In fact, hydro power developments usually increase the usefulness of water for other purposes. Certainly the criteria appropriate for determining, for example, a rate structure for the export of water would be entirely inappropriate for devising a rate for power rentals. Accordingly, the value of water in power generation cannot be measured according to the value of alternative uses.

19. The value of water in power generation might, however, be measured against the cost of alternative sources of energy for power production. At present, Ontario's principal alternative source of energy for power plants is coal, although petroleum fuels are being used in increasing proportion. The annual report of The Hydro-Electric Power Commission of Ontario for the year 1965 shows a fuel cost of $35.8 million for the generation of 10.8 billion kilowatt hours of thermal-electric power, a unit cost for fuel alone of nearly 3⅓ mills (0.33¢). Thermal power in that year approached 27 per cent of total power production. In addition, a further 7.2 billion kw.h. was purchased from outside sources, mainly in New York and Quebec, at less than 2 mills per kw.h., indicating that another source of power exists but not in sufficient quantity at the right times to eliminate the need for thermal power.

20. The water power rentals imposed on Hydro under the present agreements amount to less than 2/10 mill (0.02¢) per kw.h., a minor element of power cost being between 2 and 3 per cent of the total cost of hydro-electric power produced. We estimate that it would take an enormous increase in water power rentals to equate the cost of producing hydro-electric power with that of producing thermal-electric power. While this would provide a welcome addition to Ontario's revenues, it would be at the expense of a tremendous leap in Ontario's primary power rates. It is probably more appropriate, however, to compare the cost of hydro-electric power with the combined alternatives of low-cost imported power and high-cost thermal-electric power. We estimate that the average cost of these two taken together in the proportions now used by Hydro is less than the cost of power generated by Hydro with water. Thus we cannot conclude that the cost of power from alternative sources provides a justification for increasing water power rental rates.

21. The average revenue per kw.h. of 7.1 mills[3] from the sale of industrial power in Ontario in 1963 was only slightly above the national average. With the growing dependence on thermal-generated power in this province, the differential can be expected to increase in the future. This is particularly significant since Quebec's rates in 1963 were close to 5.5[3] mills per kw.h., a factor that must be

[3]From data supplied by The Department of Energy and Resources Management.

attractive to industries using large quantities of electricity. A significant unilateral increase in the power rates in Ontario could have an adverse effect on industrial growth.

22. On the other hand, there seems little doubt that the revenue from water power rentals could be increased, since the charge is now only a small fraction of the total cost of hydro-electric power generation, and even a doubling of the rental rate would have only a minor effect on power costs. At the same time, however, it would increase the prospective costs of precisely those primary industries that might be considering the economics of locating in the province.

23. A water power rental charge, while constitutionally permissible since it is for the use of a resource vested in the Province, can be thought of as an indirect tax—a tax on producers of hydro-generated electricity, which they will seek to pass on to their customers. Certainly the bulk of the charge, the portion paid by Hydro, tends to be shifted initially to consumers, many of whom are businesses which are also trying to recover costs from customers. We have pointed out elsewhere our concern to avoid increasing industrial costs. This, together with the lack of justification for singling out purchasers of hydro-electric power for special attention by the tax collector, dissuades us from suggesting a major increase in water power rentals. On the contrary, we believe that no unnecessary burdens should be placed on Hydro and other producers. In particular, with power costs apparently destined to increase with growing reliance on thermal generation for expanding energy needs, it is quite inappropriate to accelerate the trend artificially.

CONCLUSION

24. In our view it is entirely appropriate that some return be made to the Province from those who use water to generate electricity. A reduction of the present rate seems uncalled for and would reduce a revenue source that is already small. The present formula does have provision for increases in rates as the consumer price index rises, thus ensuring a constant real income to the Province. The existence of cheap power in Quebec, and our determination to minimize charges that raise the costs of industrial production, prevent us from recommending that rentals be maximized. We can suggest no appropriate modification of the water power rental rates in Ontario.

FISH AND WILDLIFE

25. The fish and game of Ontario are resources whose exploitation yields significant revenues to the Province, chiefly through the sale of licences. The increasing popularity of hunting and fishing has resulted in a 48 per cent rise in these revenues over the past decade, with the total in the 1966 fiscal year amounting to more than $6,153,000. Coincidentally, the amounts contributed now by the Fish Section and the Wildlife Section are similar, but wildlife revenues are growing much more rapidly.

26. Of the various licences, those for angling provide the most revenue, comprising nearly half the total. The hunting licence fees from non-residents are the largest of the hunting group, although deer, moose and gun licence revenues are all substantial. Table 34:1 presents a list of the revenue items for the year ending March 31, 1966.

TABLE 34:1

FISH AND WILDLIFE REVENUES, 1965-66

(thousands of dollars)

Fish Section		
Licences:		
Angling	2,847	
Commercial fishing	100	
Other	23	
Royalty	1	2,971
Wildlife Section		
Licences:		
Non-resident hunting	1,478	
Deer	533	
Moose	423	
Gun	328	
Trappers	33	
Other	103	
Royalty	197	3,095
General		
Licences, fines, sales, etc.		87
Total		6,153

Source: Ontario, *Public Accounts, 1966,*

27. The reader will note that the amount of royalty derived from commercial fishing is very much less than that derived from trapping. With fishing, a royalty is payable only when the catch exceeds a generous maximum free allowance which takes into account the size of investment necessary for successful commercial fishing. For trapping, on the other hand, a royalty is payable on every pelt, the amount varying according to the type of fur. The investment needed for trapping is very small, and hence no allowance is made.

28. The current revenues of the Fish and Wildlife Branch reimburse the government for its expenditures in connection with these resources. For the 1967 fiscal year, revenues are expected to exceed $6 million, and expenditures $5.8 million before the allocation of certain general overhead costs. Thus the principle of cost recovery, which we suggest for most licensing, seems to be satisfied.

29. It might nevertheless be argued that fish and game are resources that represent part of the collective wealth of the province, and that their exploitation, like that of forests or minerals, should produce a net financial return to the public treasury. On the other hand, it could be argued that government expenditures, mainly for conservation and restocking, which are financed by charges to hunters

and fishermen, benefit a considerably broader group of persons who enjoy wildlife but who are not similarly charged. Thus the public at large derives non-financial benefit that should be adequate in itself, without any financial return from the exploitation of the resource by hunters and fishermen. Before a change in policy is adopted, consideration should also be given to the possible effect on the tourist and other associated industries, if the price of sportsmen's licences were increased substantially. Certainly the arguments for changing the existing policy are not overpowering and the question must be left as one of broad social policy.

30. A point particularly worth mentioning is that the bulk of hunting and fishing revenues is provided by people who do not live in Ontario. Both angling fees and non-resident hunting fees are paid by those who come to the province to fish and hunt. No angling licences are required of residents, except in certain provincial parks, and the price of hunting licences to them is much lower. This is perhaps the most dramatic example of differentiation between residents and non-residents to be found in the provincial revenue system.

31. We are satisfied that in the case of hunting and fishing licences, there is a valid justification for not giving the same treatment to non-residents as to residents. This has been a long-standing practice not only in Ontario but in other jurisdictions. Residents may be thought to have the right to enjoy the wildlife of the province which is part of their natural heritage. People from outside the provincial borders can claim no such right and may quite properly be charged for the privilege. Indeed, when non-residents hunt and fish in Ontario, they probably interfere to some extent with residents doing the same things. In practice, the amount of revenue derived from the increased charges to non-residents is not large enough to be onerous.

32. One further point should be mentioned. The rate structure for the various classes of licences has existed for decades in its present form with only minor modifications. The last revision for hunting licences took place in 1955 and affected non-residents only. All other specific levies have remained unchanged since well before World War II. This suggests that even if the total revenue from licences is satisfactory the individual rates may require adjustment, and that a complete review of their number and administration, as well as the rates, should long since have been made. *We therefore recommend that:*

A review be made of the terms and rates of hunting and fishing licences. 34:4

Chapter 35

Revenue from Alcoholic Beverages

INTRODUCTION

1. Only the personal and the corporate income taxes, the retail sales tax, and the gasoline tax contribute more to the provincial treasury than do alcoholic beverages. As the fifth most important component of the revenue structures of Ontario, the sale and control of alcoholic beverages netted $125 million in 1965-66, over 8.7 per cent of net ordinary revenue. Only a very small proportion of this impressive sum is derived from taxes or fees; as in all other Canadian provinces and a number of American states, the bulk of it arises from direct sale of liquor through publicly owned outlets. Not surprisingly, therefore, the official Financial Report of the Province of Ontario carries liquor revenue under the heading "Trading Activities". But by no means does the provincial government traffic in liquor solely to raise revenue. It also attempts as a matter of social policy to control the distribution and consumption of alcoholic beverages. The fact that the provincial liquor trade is oriented simultaneously toward marketing and regulation explains in large part the organizational and administrative complexity that marks this field of government activity.

2. After providing a measure of historical background, we shall describe the general mechanics of liquor sales and control as they presently operate in this province. We shall thereupon proceed to examine pricing and licensing policy and then, as in our chapters on taxation, to assess the burden of and justification for government revenue from liquor. In approaching the subject at hand we are, as a committee on taxation, particularly concerned with its revenue implications. But we cannot ignore the extent to which the question of control is inextricably linked to sales and pricing policies.

GENERAL BACKGROUND

THE DEVELOPMENT OF LIQUOR REGULATION

3. The history of the sale and control of alcoholic beverages is in some ways as romantic and controversial as the story of Canada itself. Liquor, after all, was the mainstay of the fur trade. Later on, in the immediate post-Confederation era, liquor fuelled the flames of a major constitutional controversy whose outcome indelibly reshaped Canadian federalism by substantially enhancing the scope of provincial authority. Almost incidentally, the same controversy served to bring about the present constitutional division of power with respect to liquor, one in which the provinces have jurisdiction over the retail trade and the Dominion over manufacture and importation.

4. Just as the liquor trade has helped shape Canadian history, so too has it in turn been influenced by other forces in that history. At various times and in response to different viewpoints, liquor has flowed copiously or been reduced to a trickle. The most recent and best-known experiment with outright prohibition took place between 1916 and 1930 when all provinces, including Ontario from 1916 to 1927, enacted for varying lengths of time virtually total bans on liquor. The earliest known episode of national prohibition, now almost totally obscured by the passage of time, had been launched in 1679 by decree of King Louis XIV. The decree, which banned all sales of liquor to Indians in their native villages, soon passed into history. To quote Professor Donald Creighton, "The regulations and controls had behind them all the authority of provincial ordinances and all the majesty of the royal will. But how could they be enforced?"[1] That same question played no small part in the demise of the last prohibition experiment.

5. The present Liquor Control Act dates from 1927, the year Ontario emerged from prohibition. The Act created the Liquor Control Board of Ontario, which continues to this day, and gave the Board sole authority to sell alcoholic beverages and control their consumption. At first, the Board marketed beer as well as wine and liquor through its retail outlets, but within a matter of weeks the sheer physical bulk of beer and ale brought about the creation of the Brewers' Warehousing Company Ltd. This company, a non-profit distributing enterprise owned by the Canadian breweries operating in Ontario, has since been in charge of selling domestic beer and ale under Board supervision.

[1]Donald Creighton, *A History of Canada*, Boston: Houghton Mifflin Co., 1958, p. 90.

6. Emphasis on control has been part and parcel of Liquor Control Board policy since its inception, and was particularly strong in the early years. At the outset, alcoholic beverages could be purchased only for home consumption. Simultaneously, in an attempt to influence consumer preference for the less-intoxicating beverages, the Board reduced sale prices of light wines and beers. Again, from 1929 on all individuals purchasing beverages of over 4.4 per cent alcoholic content were required to buy permits.

7. A process whereby liquor regulation has been gradually liberalized to the present day began in 1934. In that year, "on-premises" consumption of wine and beer was permitted in hotels, clubs, trains and steamships licensed by the Board. Ten years later, the authority of the Liquor Control Board to deal with the issuance, transfer, suspension and cancellation of licences was transferred to a newly constituted Liquor Authority Control Board of Ontario, renamed the Liquor Licence Board in 1947. The change of name was accompanied by a thoroughgoing revision of regulations, which among other things brought the return of on-premises consumption of spirits in hotels, bars, clubs and other establishments after a lapse of over three decades. The task of licensing all such establishments was vested in the Liquor Licence Board by a new Liquor Licence Act. This and the older Liquor Control Act together comprise the present liquor law of Ontario.

8. In basic outline, the administration of Ontario liquor law has remained unchanged since 1947. But further steps to liberalize liquor control have been taken. These have included a more permissive advertising code for the liquor industry, the abolition in 1962 of individual liquor permits for off-premises consumption, and extension in 1965 of on-premises licensing to aircraft and legitimate theatres.

GROWTH AND SOURCES OF REVENUE

9. Turning from the regulatory to the revenue facet of liquor control, the contribution of alcoholic beverages to the provincial treasury since the end of prohibition is outlined in Table 35:1. The reader will note that provincial dollar revenue from alcoholic beverages generally failed to exceed $11 million annually between 1928 and the onset of World War II, and was substantially below this figure during much of the Great Depression, reflecting the close correlation between personal income and liquor consumption. The war years, despite rationing, brought liquor revenues to a peak of $20 million in 1944, largely owing to increased prices. Since 1945, provincial revenue from liquor reveals an uninterrupted upward trend marked by particularly sharp increases in the years 1947-50, 1955-59 and 1962-65. This trend produces a five-fold rise from the $25 million raised in 1946 to the $125 million realized twenty years later.

10. The upward trend in the dollar amounts derived from liquor since the War has been accompanied by a relative decline in the proportional contribution of alcoholic beverages to total revenue. The relative importance of liquor in the provincial revenue structure has fallen almost uninterruptedly from a high of close

TABLE 35:1

ALCOHOLIC BEVERAGE REVENUES, ONTARIO
SELECTED YEARS, 1928-1966

Fiscal year	*Net ordinary revenue, Ontario (1)*	*L. C. B. O. contributions (2)*	*(2) as a percentage of (1)*
	(thousands of dollars)		
1928	48,570	8,134	16.7%
1931	54,390	10,875	20.0
1934	50,068	5,732	11.4
1937	80,488	10,000	12.4
1940	88,173	9,950	11.3
1943	108,214	17,275	16.0
1946	128,369	24,733	19.3
1949	215,470	39,230	18.2
1952	302,321	42,586	14.1
1955	399,393	46,768	11.7
1958	591,849	66,673	11.3
1961	739,391	80,600	10.9
1962	825,352	82,500	10.0
1963	993,612	87,500	8.8
1964	1,079,136	97,100	9.0
1965	1,237,244	113,000	9.1
1966	1,442,845	125,200	8.7

Source: Ontario, Public Accounts.

to 20 per cent in 1948 to the present level of slightly under 9 per cent, a proportion below even the historical lows that prevailed in the Depression and the early war years. That declining relative importance should be coupled with large increases in dollar revenue is due, of course, to the growing diversity and productivity of the total revenue structure, especially in the domain of income and consumption taxes.

11. To round out the statistical picture, we shall outline the principal sources from which the Province derives liquor revenue at present. By far the major source is comprised of the net sales of spirits, wine and beer by the Liquor Control Board of Ontario. Accounting for 77 per cent of the total, this item represents the "profit" on sales which the Board turns over to the Province. It should be noted that beer sales incorporated in this figure include sales of all the foreign beer sold in Ontario and only a small amount of Canadian beer. Domestic beer is carried by the Liquor Control Board stores only in small communities. Next in order of importance at 16 per cent of the total are taxes and fees on the sale of beer through brewers' own retail stores and Brewers' Warehousing Company Ltd. Licence fees levied under The Liquor Licence Act were third with 6 per cent of the total, while tax and licence fees on Canadian wine sales together with miscellaneous revenues, represent slightly over 1 per cent and account for the rest. To gain a somewhat clearer perspective, the reader may wish to consider Ontario's revenue from alcoholic beverages as stemming from:

(1) the "mark-up" made by the Liquor Control Board on its own sales;

(2) taxes and fees on sales of Canadian wine and beer by non-Board outlets; and

(3) licence fees imposed by the Liquor Licence Board on licensed premises.

THE MECHANICS OF SALE AND CONTROL

12. Two statutes, The Liquor Control Act and The Liquor Licence Act, govern the sale and control of alcoholic beverages in Ontario. While these statutes are sufficiently interrelated that they cannot usefully be subjected to separate examination, they do offer ground for a convenient distinction to which we can adhere for descriptive purposes. This distinction is between the consumption of alcohol by the bottle off the premises of the vendor in the residence of the purchaser (*off-premises consumption*) and the consumption of alcohol by glass or bottle on licensed premises (*on-premises consumption*).

SALE AND CONTROL: OFF-PREMISES CONSUMPTION

13. The sale and control of alcoholic beverages for off-premises consumption flows through four channels: the *Liquor Control Board of Ontario*, the *Brewers' Warehousing Company Ltd., brewers' own retail stores* and *wineries' own retail stores*. The operations of each of these four channels of distribution will be described in order.

The Liquor Control Board of Ontario

14. Generally speaking, the Liquor Control Board is the government's master agency with respect to all facets of liquor policy, whether in the realm of revenue or in that of sale and control for on- or off-premises consumption. As its responsibilities pertain specifically to off-premises consumption, the Board operates more than 400 stores throughout the province, and through these stores is the sole outlet in Ontario for the sale of imported and Canadian spirits, and imported wine and beer. Domestic wine is carried by all Board stores, but may also be purchased directly from the retail stores that Ontario wineries are permitted to operate for the sale of their own products. Board stores do not carry Canadian beer, except for outlets specifically designated as combination stores, of which some 100 were in operation during 1965. Combination stores are set up in municipalities where, because Canadian beer sales are less than 40,000 to 50,000 gallons annually, it is not economical to establish separate Brewers' Retail stores. Both regular and combination stores are, of course, staffed and run by the Liquor Control Board. A third type of Board store, known as an agency store, has emerged in the more remote areas of northwestern Ontario, as a result of recent innovation. Agency stores are local, usually general, stores which operate as Board-controlled outlets in small communities. These stores purchase their liquor stock for local retailing from the nearest regular or combination Board store at a discount of 10 per cent on all purchases up to $40,000 and 5 per cent on purchases over this amount. There were twenty-one agency stores in 1965.

15. The Liquor Control Board is constantly at work surveying need and possible locations for new stores as communities grow. It also receives each year an appreciable number of applications for new stores from municipalities and interested groups. Decisions on store location can have significant implications for the development of other retailing activities and for community and neighbourhood development generally. Accordingly they are preceded by thoroughgoing review of volume of business and proximity to churches, schools and related establishments. Growth in the sale of an area's existing stores is considered more indicative of need for a new outlet than any specific relationship between the number of stores and population density.

16. All Board sales, whether to a person or his agent, whether by regular, combination or agency stores, and whether picked up or delivered, are made on the basis of order slips filled out by each individual customer. The slips show the quantity and type of liquor purchased, and require the purchaser's name and address. The slips provide the basis for store bookkeeping and inventory control, and they also enable the Board to analyse demand for liquor by type and location. Requirement of the customer's signature is considered a useful adjunct of regulation, although the Board admits that its control over the purchase of alcoholic beverages by minors and other prohibited persons is more effective in small centres than in large ones. The practice of requiring signed slips is carried over to Canadian beer and wine outlets as well as Board stores.

The Brewers' Warehousing Company Ltd.

17. The Brewers' Warehousing Company is a pool-distributing non-profit organization owned co-operatively by eight breweries whose products it sells.[2] The company's proceeds are returned to the individual breweries in proportion to each brewery's sales after deducting a prorated charge for handling. Brewers accordingly shoulder operating costs in direct proportion to their sales. The company operates the familiar Brewers' Retail stores, of which there are over 320 in the province. Liquor Control Board regulations cover, among other things, pricing, hours of business and the requirement of signed order slips.

Brewers' Own Retail Stores

18. Brewers' own retail stores, as the name implies, are simply sales outlets located on the brewing premises of each individual brewery. These stores sell and deliver the brands of the individual brewery only, and are subject to the same Liquor Control Board regulations as Brewers' Warehousing Company outlets.

Wineries' Own Retail Stores

19. Historically speaking, wineries' own retail stores are basically similar to brewers' own retail stores, that is, outlets located on a winery's premises for the sale of that winery's products. But since the 1930's the Province has been encouraging wineries to combine operations and improve efficiency, and to this end

[2]The eight breweries are: Beck Brewing Company Ltd., Carling Breweries Ltd., Doran's Northern Ontario Breweries Ltd., Dow Brewery (Ontario) Ltd., Formosa Spring Brewery Ltd., Labatt's Ontario Breweries Ltd., Molson's Brewery (Ontario) Ltd., and O'Keefe Brewing Company Ltd.

has permitted them to retain the retail operations of a winery closed down through consolidation. As a result, there are at present fifty-one company-owned winery retail stores in Ontario, but only nine wineries, and the location of retail outlets no longer coincides with the wineries' premises and indeed may be changed with Board permission. Wineries' own retail stores account for approximately 40 per cent of Canadian wine sales, the remainder being marketed in Liquor Control Board stores. Wineries' own stores, like the brewers' outlets, are fully regulated by the Board.

SALE AND CONTROL: ON-PREMISES CONSUMPTION

20. Alcoholic beverages sold for on-premises consumption, like those sold for off-premises consumption, have been purchased from Liquor Control Board stores, Brewers' Warehousing, breweries or wineries. But the fact that they are ultimately consumed on licensed premises involves a quite different complex of administrative procedures.

The Liquor Licence Board

21. Composed of three members appointed by the Lieutenant Governor in Council, the Liquor Licence Board is charged under The Liquor Licence Act with the task of licensing various classes of establishments for the sale of liquor for on-premises consumption. The Board is responsible for inspecting and supervising its licensees and, in conjunction with municipal and provincial police forces, for disciplining those guilty of violating The Liquor Licence Act. Its offices are located in the same building as the Liquor Control Board, which collects its fees and provides it with accounting services. Like the Liquor Control Board, the Licence Board reports annually to the Lieutenant Governor in Council and has the Provincial Secretary as the minister responsible.

22. Liquor licences may be granted by the Liquor Licence Board to hotels, inns, taverns, theatres, restaurants, public houses, clubs, military messes, aircraft, railway cars or passenger steamships. There are six classes of licence, as follows:

1. *Dining Lounge* for the sale and consumption of all alcoholic beverages with meals.
2. *Dining Room* for the sale of beer and wine only with meals.
3. *Lounge* for the sale and consumption of all alcoholic beverages.
4. *Public House* for the sale and consumption of beer on premises to which men only are admitted, and for the sale and consumption of beer on premises to which women only or women escorted by men are admitted.
5. *Club* for the sale of all alcoholic beverages with or without meals in an establishment classified as a "club".
6. *Club (restricted)* for the sale and consumption of beer and wine with meals and beer without meals in an establishment classified as a club.

All these licences are annual and expire on March 31 each year. In addition, the Licence Board grants "special occasion permits"—formerly called banquet permits

—to individuals or groups who wish to serve liquor at a function held at a specified time and place.

23. Table 35:2 offers a summary of the number of licences issued by the Liquor Licence Board to various establishments, together with the number of special occasion permits, for selected fiscal years from 1948 to 1964. As for licences, all establishments covered by the Table reveal a steady increase in the number of licensed premises, with the sole exception of public houses, which have been declining in line with the Licence Board's announced policy of discouraging this type of outlet. Total licences issued by the Board rose by slightly over 50 per cent between 1948, its first full year of operation, and 1964, from 1,733 to 2,623. Special occasion permits, for their part, leaped forward particularly quickly at the outset, jumping by a factor of more than four between 1948 and 1954, and continued to grow steadily if less spectacularly over the following ten years, reaching a total of 74,033 in 1964, somewhat less than double the 40,725 issued in 1954.

Table 35:2

LIQUOR LICENCES AND SPECIAL OCCASION PERMITS, LIQUOR LICENCE BOARD OF ONTARIO

SELECTED FISCAL YEARS, 1948-1964

	1948	*1954*	*1960*	*1964*
Hotels	800	906	988	1,115
Taverns	106	169	182	306
Public Houses	390	351	329	311
Restaurants	14	17	17	20
Social Clubs	159	206	225	307
Veterans' Clubs	163	249	284	380
Labour Clubs*	—	14	21	25
Military Messes	94	128	140	153
Railways†	—	—	2	3
Steamships	7	3	3	3
Theatres and Aircraft‡	—	—	—	—
Total	1,733	2,043	2,191	2,623
Number of Special Occasion (Banquet) Permits	9,679	40,725	64,401	74,033

Source: Annual Reports of the Liquor Licence Board.

*Labour Club Licences included in Veterans' Club Licences in 1948.

†No licences issued prior to 1954.

‡No licences issued prior to 1966.

24. While special occasion permits are generally granted as a matter of straightforward administration by the Licence Board staff, the issuing of liquor licences involves a complex of procedures culminating in a decision by the Board proper. As a basic prerequisite, no licence may be issued in any municipality, save for Toronto, Hamilton, Ottawa, London and Windsor, unless a favourable vote of the municipal inhabitants authorizing the issuance of each class of licence has first been obtained. The vote in favour must be 60 per cent. Only the five cities designated above as exceptions are exempt from the voting requirement.

25. If the municipality is exempt from the voting requirement, or has duly authorized licensed premises by plebiscite, an application to the Licence Board may be entertained. Applicants receive a preliminary screening from the Board staff to determine if they are worthy of formal consideration. This screening may include an informal hearing by the Board. While the criteria applied at this juncture are not entirely clear, it is apparent that the Licence Board's principal concern revolves around the financial resources and business know-how of the applicant. Once he has passed the preliminary screening, the applicant proceeds to a formal hearing before the Licence Board. For hearing purposes, the Board has divided the province into fourteen districts in each of which it sits twice annually. The applicant's appearance before the Board is open to the public and is preceded by a staff investigation. While the applicant may be told of the Board's decision at the conclusion of the hearing, normally he receives the verdict by letter at a later date. If the application has been denied, the letter will state the reasons. The successful applicant must undertake to operate the establishment himself during at least the first three years. After the minimum period has elapsed the licence may be transferred with Board approval on payment of a transfer fee.

26. The operator of a licensed premises is responsible at all times for managing his establishment in conformity with the provisions of The Liquor Control and Liquor Licence Acts. The Board may at any time cancel a licence, disqualify an individual licence holder or a particular premises from eligibility for a licence, and "impose such conditions upon the holder of the licence as the circumstances require".[3] Under The Liquor Licence Act, a licence shall be cancelled:

(a) if the licence holder persistently fails to comply with The Liquor Control or Liquor Licence Acts or the regulations made thereunder;

(b) if the licence holder persistently fails to carry out the orders of the Liquor Licence Board, the Liquor Control Board or the Fire Marshal of Ontario;

(c) if the licence holder persistently fails to keep the licensed premises in a clean and sanitary condition;

(d) if the licence holder persistently fails to comply with any municipal by-law affecting his premises; or

(e) if any circumstances arise which would have prevented the issuing of a licence in the first place.

The last-mentioned set of circumstances is a catch-all category that covers a number of general points—for instance, a licence holder must be a "fit and proper person", he must be the true owner of the licensed premises, and must have no criminal record.

27. Cancellation procedure requires a hearing before the Licence Board which takes place on application either by the Board staff or by a third party.

[3]The Liquor Licence Act, R.S.O. 1960, c. 218, s. 42 (d).

Since 1951, the Board has been required to state the reasons for a cancellation or suspension of licence at the conclusion of the hearing. While there was no provision for appeal from a Board cancellation until 1962, an amendment to The Liquor Licence Act passed in that year extended the appeal provisions of The Liquor Control Act to cases of licence cancellation. Appeal is to a county or district court in the first instance and thence to the higher courts in accordance with their procedures. There is, of course, no appeal from a decision of the Licence Board to issue or deny a licence to an applicant in the first instance. Here, the Licence Board is essentially performing an action that involves interpretation of legislative policy. On the other hand, because the ground for a cancellation decision shifts from discretionary conditions to standards of performance that can be specified, such a decision is appropriately open to the full range of judicial review.

ALCOHOLIC BEVERAGE REVENUE POLICIES

28. As we have already had occasion to point out, revenue from alcoholic beverages is derived in Ontario from three principal sources: the Liquor Control Board "mark-up", taxes and fees on sales of Canadian wine and beer, and licence and related fees. The all-important base on which the revenue system operates is sales, whether for off-premises consumption or for ultimate consumption on licensed premises. As to the actual revenue tapped from liquor consumption in any given year, the focal point of the sale and control system is the Liquor Control Board of Ontario. The Control Board not only accounts for all sales and hence prices of spirits and imported wine, but directly prices domestic wine, heavily influences the price of Canadian beer, and has a direct bearing, through prices, on Liquor Licence Board fees which are themselves based in large part on the value of purchases by licensed premises.

29. A brief look at the composition of the dollar value of alcoholic beverage sales is appropriate. In 1963-64, of the $421 million total sales, the Liquor Control Board accounted for over half, 54.5 per cent, with Brewers' Warehousing and individual brewery stores following closely at 44 per cent, and winery stores contributing a relatively insignificant 1.5 per cent. Spirits constituted the overwhelming bulk of Control Board sales, with Canadian spirits providing more than five times the amount contributed by imported spirits.

THE LIQUOR CONTROL BOARD AND PRICING POLICY

30. The Liquor Control Board influences prices at two distinct points. The first is at the point of purchase from domestic distilleries and wineries, and the second is at the point of mark-up determination. While the Liquor Control Board cannot exactly dictate the price at which it will purchase alcoholic beverages, it wields considerable influence as the largest individual customer of domestic wineries and distilleries. Among the Board policies with a particular impact on alcoholic beverage producers is its practice of pricing most items in clearly defined price brackets. Producers are conscious that a slight increase in price might elevate a given product to a higher price bracket, at which level its quality might be inferior

TABLE 35:3

LIQUOR CONTROL BOARD PRICING STRUCTURE, SELECTED ITEMS
FEBRUARY 1, 1967

Quantity	Brand	Cost (Cdn. $)	Freight and insurance	Federal duty excise	Federal sales tax (12%)	Total cost	Basic selling price	Per cent profit on cost	Provincial sales tax (5%)	Retail price
	Domestic									
1 bottle	Walker's Royal Scot Whisky.........	$ .91	inclusive	$ 1.42	$ .28	$2.61	$ 4.69	79.6%	$ .23	$4.92
1 bottle	Seagram's Crown Royal Whisky.....	1.94	inclusive	1.42	.40	3.76	6.70	78.2	.34	7.04
1 bottle	Walker's Special Old Whisky........	.79	inclusive	1.42	.27	2.48	4.40	77.4	.22	4.62
1 bottle	Gilbey's Dry Gin..................	.70	inclusive	1.42	.25	2.37	4.31	81.9	.22	4.53
1 bottle	Capt. Morgan Black Label Rum.....	.80	inclusive	1.42	.27	2.49	4.50	80.7	.23	4.73
1 bottle	Chateau Gai Gr. Chat. Cream Port...	1.05	inclusive	.08	.13	1.26	2.01	59.5	.10	2.11
1 bottle	Brights Hermit Sherry	.48	inclusive	.08	.06	.62	1.00	61.3	.05	1.05
	Imported									
1 bottle	Dewar's Special Scotch.............	1.08	$ .10	1.48	.31	2.97	5.93	99.7	.30	6.23
1 bottle	Booth's House of Lords Gin.........	.42	.05	.71	.14	1.32	2.72	106.1	.14	2.86
1 bottle	Pilsner Urquell Beer................	.13	.06	.04	.02	.25	.38	52.0	.02	.40
1 bottle	Bouchard Chablis..................	1.07	.14	.11	.14	1.46	2.96	102.7	.15	3.11

Source: Liquor Control Board of Ontario.

to similarly priced products. It is therefore customary for distilleries and wineries to consult the Liquor Control Board about proposed price changes. The Board may in turn discuss pricing with liquor boards in other provinces, and domestic producers will usually participate in these discussions as well. As is to be expected, the Board wields no comparable influence over the foreign producers of the spirits, wine and beer that it imports.

The Liquor Control Board Mark-up

31. Once the price at which the Control Board will purchase different products has been set, the Board, as a matter of long-standing practice, works out its mark-up as a calculated percentage of its purchase price. The final selling price, in addition to mark-up, covers the purchase price paid by the Board to the producer, freight and insurance costs, federal excise duties, the federal manufacturers' sales tax, and the provincial retail sales tax.

32. Table 35:3 offers a summary example, supplied by the Liquor Control Board of Ontario, of the several price components of selected individual items by the bottle according to the price structure in effect in 1967. The size of mark-up varies widely from item to item, and to the best of our knowledge is based more on custom than reason. Mark-up differs also by size of bottle, and is generally some 1.5 per cent higher on twelve-ounce than on twenty-five-ounce bottles.

33. The Board mark-up is singled out for the reader's consideration in Table 35:4, which shows average mark-ups for major product categories in recent selected years.

TABLE 35:4

AVERAGE MARK-UPS ON COST FOR MAJOR SPIRIT AND WINE GROUPS, ONTARIO SELECTED YEARS, 1952-1967

	1952	1956	1964	1967
Imported liquor	89½%	96%	96%	102%
Canadian spirits				
medium- and high-priced	62½	65½	74	79
low-priced	52½	57½	69½	78
Domestic wine	36	40	51½	64
Imported wine	89½	96	96	105

With respect to Canadian spirits, the Table offers a concrete illustration of the influence that custom wields over mark-up determination. The difference between the rate of mark-up applied to low- as opposed to medium- or high-priced Canadian spirits is a legacy from the 1930's when it represented a difference in alcoholic strength. The alcoholic strength of all spirits has been standardized at 30 under proof since World War II, and while the gap has admittedly narrowed, a smaller

mark-up rate continues to apply to low-priced spirits. On the ground that the reason for any gap has long ceased to exist, *we recommend that*:

The Liquor Control Board of Ontario be instructed to bring its mark-up on so-called "low-priced" Canadian spirits into line with the mark-ups that it applies to other Canadian spirits. **35:1**

34. Much more striking than any variation in the mark-up of Canadian spirits is the large mark-up differential that Table 35:4 reveals between imported and domestic products, whether spirits or wine. While it is apparent that in the last several years the Liquor Control Board has increased its mark-up on Canadian products more rapidly than on imported products, a sizeable gap remains, illustrated by the 102 per cent mark-up applied in 1967 to imported spirits in contrast to the 79 per cent applied to Canadian medium- and high-priced spirits. It is obvious that there can be no explanation for such a gap other than conscious discrimination in favour of Canadian products. We have taken considerable pains to develop elsewhere in this Report the view that protection for Canadian industry has no place in a proper provincial revenue system. Protectionism is a matter for the federal government to determine, and to implement through customs duties and other instruments. *We therefore recommend that*:

The Liquor Control Board of Ontario apply the same mark-up to the cost of an imported spirit, wine, or malt beverage as is used for the corresponding class of domestic product. **35:2**

The Special Position of Ontario Wine

35. The realm of protectionism brings us to wine as a special case in point. Presumably to stimulate the Ontario grape-growing industry, Ontario wineries have been compelled to use only Ontario grapes for wine production. The Liquor Control Board abets this policy both at the point of purchase and at that of mark-up determination. As of February 1967 the cost to the Board of inexpensive Ontario dessert wine exceeds that paid by the liquor boards of the other Canadian provinces for which we have data, despite the smaller shipping costs for Ontario. The Board then applies an appreciably lower mark-up to the wine than do the other boards. It thereby absorbs the cost of its subsidy rather than passing it on to the consumer. And by charging the lowest price in Canada, the Board stimulates demand for Ontario wine. The outcome of this situation is illustrated in Table 35:5, which shows by province the laid-down cost—that is, purchase price including federal taxes plus freight—, mark-up, and selling price of one bottle of Ontario dessert wine. Ontario's artificially high laid-down cost of 62¢, and its remarkably small mark-up of 38¢—61.3 per cent of cost, the lowest in Canada, spell protectionism in hard figures. As a committee on taxation, we are in no position to judge the wisdom of a government policy designed to stimulate the grape-growing industry in Ontario. But we can and do suggest that the appropriate

instrument for such a policy, if indeed it is deemed in the public interest, should be a direct subsidy rather than the manipulation of the revenue system. Accordingly, *we recommend that*:

The Liquor Control Board of Ontario purchase Ontario wines at prices no higher than those dictated by market forces. **35:3**

TABLE 35:5

COMPARATIVE MARK-UPS OF PROVINCIAL AUTHORITIES
ON CANADIAN DESSERT WINE
FEBRUARY 1, 1967

	Laid-down cost per bottle	*Mark-up*	*Selling price (ex. provincial sales tax)*	*Percentage mark-up on cost*
Newfoundland	$ .57	$ .88	$1.45	154.4%
Prince Edward Island	.60	.67	1.27	111.7
New Brunswick	.55	.68	1.23	123.6
Nova Scotia	.54	.51	1.05	94.4
Ontario	.62	.38	1.00	61.3
Manitoba	.50	.50	1.00	100.0
Alberta	.59	.51	1.10	86.4

Source: Figures were supplied by the various provincial liquor boards.

Notes: 1. The Ontario example used is Brights Hermit Sherry.
2. Freight has been included for all provinces except Ontario, where price quoted is for goods delivered to warehouse.
3. The liquor boards of Quebec, Saskatchewan and British Columbia did not supply comparable data.

TAXES AND FEES ON THE SALE OF CANADIAN WINE AND BEER

36. Taxes and fees, as opposed to mark-up, constitute the means whereby the Province derives revenue from sales of Canadian wine and beer not transacted through Liquor Control Board stores. Non-Board sales through winery stores account for approximately 40 per cent of Canadian wine sales in Ontario. In the case of Canadian beer, all sales are through the Brewers' Warehousing or brewers' own stores, save for a tiny proportion, about 3 per cent, transacted directly by the Liquor Control Board through its combination stores.

Fees for Wineries and Breweries

37. Each winery in Ontario is charged an annual licence fee of $500, and each brewery a fee of $1,500 as a permit to operate in the province. An additional fee of $100 per store is charged for each of the fifty-one winery-operated stores. Every brewery pays an additional fee of $100 per store for each Brewers' Warehousing outlet that stocks the brewery's product. There appears to be little rhyme or reason to the fee structure that applies at present to breweries and wineries. We believe that these fees, like the general provincial licence fees we have discussed elsewhere, should be set on what is essentially a cost-recovery

basis, sufficient to reimburse the province for the expenses it incurs in regulating the wineries and breweries of Ontario. Accordingly, *we recommend that*:

The licence fees at present levied on breweries and wineries be altered so that the revenue will approximate the costs of licensing and inspection. **35:4**

The Tax on Canadian Wine

38. This tax applies only to the Canadian wine sales made by the winery stores. It is set at a rate of 10½ per cent of the gross selling price before provincial retail sales tax. Winery stores must, of course, retail their own wine products at prices identical to those obtaining in Liquor Control Board stores. The wine tax rate is of considerable concern to us, especially when we contrast it to the average mark-up of 38 per cent of gross selling price before provincial retail sales tax that the Board applies to the domestic wine it sells through its own stores. If the cost of operating winery stores is at all comparable to that of operating Board stores, the wine tax at its present rate creates a windfall for the wineries and a considerable discrepancy in the revenue that accrues to the Province as between winery store and Board store sales. *We therefore recommend that*:

The tax on winery store sales be adjusted so that the rate of provincial revenue from sales of domestic wine in winery and Liquor Control Board stores will be equated to the extent possible without the wineries being deprived of a reasonable rate of return from their retailing operations. **35:5**

Canadian Beer: Pricing and Gallonage Tax

39. The retail price of Canadian beer is set according to clear-cut policies agreed upon by the breweries and the Liquor Control Board. Uniform prices prevail for all brands throughout southern Ontario, save for two premium-priced beers that retail for somewhat more per case than the other brands. A price differential due to added transportation costs applies to all beer sold in northern Ontario, amounting to 15¢ on a case of twelve small bottles and 25¢ on a case of twenty-four small bottles. Beer is retailed only in "small", that is twelve-ounce, bottles, except in eastern Ontario where it is also available in "large" twenty-two-ounce bottles popular in that part of the province.

40. In those instances where the Liquor Control Board itself sells beer through a combination store, it deducts a flat 10 per cent from the retail price and remits the balance to the Brewers' Warehousing Company. All remaining revenue is derived from a gallonage tax. The gallonage tax is levied on the breweries at the rate of 16.5¢ per gallon for the first two million gallons produced and 18.5¢ for each gallon above the two million mark. At the 16.5¢ rate, the gallonage tax amounts to 30¢ on a case of twenty-four small bottles. Because a province can constitutionally impose direct taxes only on persons within its boundaries, the gallonage tax does not apply to beer produced in Ontario for shipment elsewhere. But the gallonage tax is applied to beer produced outside Ontario for sale within the province, in this instance at the flat rate of 18.5¢ per gallon.

41. On beer produced and sold in Ontario, the split rate in gallonage tax, 16.5¢ payable on the first two million gallons and 18.5¢ per gallon on the rest, has frankly puzzled us. We have been unable to discover any particular justification for such a split. We duly note that all beer produced outside the province for sale in Ontario is taxed at a flat per-gallon rate. Accordingly, *we recommend that:*

> ***The gallonage tax on breweries be set at a single rate per gallon for all beer produced and sold in Ontario.*** **35:6**

LICENCES AND FEES UNDER THE LIQUOR LICENCE BOARD

42. The licence and other fees administered by the Liquor Licence Board constitute the third important component of provincial liquor revenue. These fees, together with pricing, are the means whereby the provincial treasury taps on-premises consumption of alcoholic beverages.

Pricing Policy for On-premises Consumption

43. Licensed outlets purchase spirits and wine for sale on the premises at prices identical to those charged home consumers. The price they charge their customers in turn is entirely at their discretion, although the regulations do specify that a drink of spirits must contain not less than one fluid ounce. By regulation, draft beer must be served for 15¢ in a glass with a capacity of 9.5 fluid ounces filled with not less than 7.6 fluid ounces of beer. Where beer clearly departs from spirits and wine is in the price charged to licensed outlets by Brewers' Warehousing. Ever since its founding, Brewers' Warehousing has been permitted to offer a discount on sales to licensed premises. While the size of the discount has varied over the years, it has climbed steadily from a low of 4.5 per cent on a case of twenty-four small bottles in 1950 to 25 per cent at present.

44. As we shall see later in this chapter, there may be valid reasons for a lower price structure for beer than for other alcoholic beverages. But to fix a lower price for beer purchased by licensed premises than for that purchased by home consumers when the price charged for all other alcoholic beverages is uniform surely has little basis in reason. *We therefore recommend that*:

> ***The price of beer to home consumers and licensed premises be made uniform.*** **35:7**

Licence Fees

45. The Liquor Licence Board imposes a filing fee of $10 per licence application, whether initially or for renewal. Licence fees proper are levied strictly in accordance with the licensee's annual liquor purchases, save for the Mess of an active service unit or a national defence establishment where a flat rate of $50 per year applies. Table 35:6 sets out the fee scales under the six classes of licence—Dining Lounge, Dining Room, Lounge, Public House, Club, and Club (restricted)—together with the various types of establishments eligible for such licences.

46. The reader will observe a striking contrast between the licence fee as it applies to spirits and wine and licence fee on beer. The former is a clear-cut 10 per cent of the gross value of a licensee's annual purchases. But the latter, which

TABLE 35:6

LICENCE FEES UNDER THE LIQUOR LICENCE ACT, 1966

Establishment	*Licence*	*Spirits and wine*	*Beer gallonage charge*	*Wine only*
or Inn	Dining Lounge Licence	10% gross value	10-26¢	N/A
	Lounge Licence	10% gross value	10-26¢	N/A
	Dining Room Licence	N/A	10-26¢	10% gross value
	Public House Licence	N/A	10-26¢	N/A
or Theatre	Dining Lounge Licence	10% gross value	11-39¢	N/A
	Lounge Licence	10% gross value	11-39¢	N/A
	Dining Room Licence	N/A	11-39¢	10% gross value
rant	Dining Room Licence	N/A	10¢	10% gross value
House	Public House Licence	N/A	13-52¢	N/A
	Club Licence	10% gross value	11-21¢	N/A
	Club Licence (Restricted)	N/A	13-26¢	10% gross value
ns' Club	Club Licence (Restricted)	N/A	8-13¢	10% gross value
y Mess — rve Units	All types of licences	10% gross value	8-13¢	10% gross value
y Mess — ve Unit onal Defence blishment	All types of licences flat fee of $50			
t, Railway or Steamship	Dining Lounge Licence	10% gross value	10-16¢	N/A
	Lounge Licence	10% gross value	10-16¢	N/A
	Dining Room Licence	N/A	10-16¢	10% gross value
	Public House Licence	N/A	10-16¢	N/A

is in the form of a gallonage charge, shows wide variation on two kinds of bases. The first basis, plainly evident in Table 35:6, is by type of establishment. Thus, to take a random example, a hotel or inn with a dining lounge licence will pay a gallonage charge on a scale graduated from 10¢ to 26¢, a tavern or theatre with the same class of licence will pay on a scale from 11¢ to 39¢, and a restaurant with the same class of licence will pay a flat 10¢ per gallon. The second type of variation is on the basis of the quantity of a licensee's annual beer purchases. Again to pick an example, the fee schedule on a social club licence is graded from 11¢ to 21¢ by steps geared to every 10,000 gallons purchased, as shown in Table 35:7.

TABLE 35:7

LICENCE FEE SCALE FOR BEER, SOCIAL CLUB LICENCE, 1967

On first 10,000 gallons	11¢
On 10,001 - 20,000 gallons	13¢
On 20,001 - 30,000 gallons	16¢
On 30,001 - 40,000 gallons	18¢
On 40,001 gallons and over	21¢

47. That different scales of beer gallonage licence fees should apply to different establishments with the same or a differing class of licence is to us nothing if not arbitrary. Nor do we consider justifiable the favoured status that the fee structure grants to veterans' clubs and military messes. As to the practice whereby beer gallonage fee scales are geared to the number of gallons purchased, we are again unable to discover an acceptable rationale. It is alleged that the gallonage scale enables the Province to tap revenue from the high-volume operations of large establishments while granting relief to small operators who suffer losses on unsaleable draught beer. If the size of an operation provided an indication of its profitability, some variation in fees might well be warranted. But the correlation between scale and profit is sufficiently haphazard to provide only the flimsiest pretext for existing fee scales. Accordingly, *we recommend that*:

> ***The licence charge based on beer consumption be set at a single rate applicable to all types of licensed premises.*** **35:8**

48. At this juncture, we are admittedly begging the question of what might be rational policy with respect to liquor licence fees. We have two basic points to offer. The first, which we have taken pains to develop elsewhere in this Report, is that a provincial licence fee should be set so as to cover issuing costs and the expenses incurred by the Province in regulating the activities permitted by the licence. As regards liquor, the latter expenses would include provision for inspectors, administration and enforcement. Our second point relates to the peculiar market position that a liquor licence occupies. Liquor licences essentially limit the number of outlets, thereby restricting competition among them and accordingly enabling them to sell their product at prices higher than would obtain if there were free entry and unrestricted competition. Liquor licences thus favour their holders with, to use the economist's jargon, conditions of monopolistic competition. We believe that it is reasonable for the provincial government to tap those excess profits that accrue to a licensee as a result of the monopolistic position which he occupies. Accordingly, *we recommend that*:

> ***After thorough study by the Liquor Licence Board, liquor licence fees be set on a basis such that in addition to covering all issuing and regulatory costs, they will appropriate to the Province any monopolistic profits that the licensing system has made possible.*** **35:9**

Municipal Enforcement

49. Our viewpoint to the effect that licence fees should always cover the costs of applying and enforcing regulations has a special implication in the field of liquor. Here costs accrue not only to the Province but to the municipalities whose police forces shoulder much of the burden of enforcing The Liquor Control and Liquor Licence Acts. In recognition of the financial consequences, the Liquor Licence Board annually remits to each municipality with which it has an enforcement agreement 20 per cent of the licence fees originating in that municipality and

60 per cent of the fines imposed under the liquor acts. Since they are part and parcel of the enforcement process, we deem it only fair that municipalities should continue to participate in provincial liquor revenue. We are concerned that the amount of payment to the municipalities should reflect as closely as possible the cost to them of their participation in the enforcement process. We note that the different liquor licence fee structure we recommend will necessitate in any event a review of existing agreements between the Licence Board and municipalities. Accordingly, *we recommend that*:

> ***The financial basis of the agreements whereby municipalities receive payments from the Liquor Licence Board be adjusted so that such payments will reflect as closely as possible the cost to the municipalities of enforcing The Liquor Control Act and The Liquor Licence Act.*** **35:10**

Transfer Fees

50. The Liquor Licence Board closely regulates the transfer of liquor licences from one operator to another. Such transfers cannot be effected without the Board's approval. They are also a source of considerable provincial revenue, amounting to over $750,000 in 1963-64. Fees are levied on all transfers except those that occur within the immediate family on the death of the licence holder. Where a transfer is from a living person to his immediate family, there is a flat fee of $100. For the rest, all fees are payable by the vendor according to two scales —one for beer, the other for spirits and wine—each of which relates to the gross value of the licensee's alcoholic beverage purchases during the preceding twelve months. The beer portion of the transfer fee is on a gallonage basis and ranges on a sliding scale from 10 per cent of the net value of beer purchased up to 10,000 gallons, with a minimum of $100, to 130 per cent of the net value of beer purchased over 120,000 gallons. As it applies to spirits and wine, the transfer fee scale begins at 10 per cent of the value of spirits and wines purchased to a value of $20,000, and proceeds upward to 130 per cent where the value of the purchases exceeds $170,000. Transfer fees are prorated when partnership interests are split or where the premises have been in operation for less than twelve months.

51. Table 35:8 lays out the total number of transfers, transfer fees by size, and the dollar revenue derived from transfer fees for selected years from 1955 to 1964. To take the fiscal year 1963-64 as an example, most transfers—indeed, 72 per cent—were small and entailed fees of $5,000 or less. On the other hand, one transfer incurred a fee of $50,000 and five other fees between $25,000 and $50,000. The reader will note that transfer fee income tends to fluctuate from year to year in accordance with the number and value of transfers.

52. The transfer fee was initiated by the province in order to enable it to draw revenue from the presumed monopolistic profits of high-volume licence holders. While the fee is legally payable by the vendor it will often in fact be paid by the purchaser so that the government really does not participate in past success but instead places an obligation on the future operations of the new owner. The

Table 35:8

TRANSFER FEE REVENUE AND TRANSFERS BY SIZE OF FEE, SELECTED FISCAL YEARS, 1955-1964

	1955	*1958*	*1961*	*1964*
Over - $50,000	1	—	1	1
$30,000 - 50,000	—	1	2	4
$25,000 - 30,000	1	2	1	1
$20,000 - 25,000	—	1	2	2
$15,000 - 20,000	4	4	6	2
$10,000 - 15,000	11	8	7	9
$ 5,000 - 10,000	26	13	25	26
$ 2,500 - 5,000	55	45	39	32
$ 1,000 - 2,500	39	29	51	20
Under - 1,000	25	23	20	26
$ 100 or less	52	49	43	49
Total Fee Transfers	214	175	197	172
Total Transfers	241	214	217	208
Fees Collected on Transfers	$773,705	$672,600	$649,804	$788,674

Source: Liquor Control Board of Ontario
The difference between total fee transfers and total transfers represents transfers without fee—i.e., within the family.

avowed purpose of the transfer fee is thereby frustrated. No other Canadian province exacts a transfer fee except British Columbia, and there the fee is a flat $25. If Ontario is indeed concerned with the recovery of monopolistic profits, then we suggest that the appropriate means is through the licence fee system that we have recommended above. Transfer fees as such should be at a level no higher than that necessary to cover the expenses of the Liquor Licence Board in regulating transfer. *We therefore recommend that*:

The transfer fees now in effect for liquor licences be abolished and replaced by a flat fee to yield an amount not exceeding the administrative costs to the Liquor Licence Board of effecting and regulating transfers. **35:11**

Special Occasion Permits

53. Special occasion (formerly banquet) permits must be secured for all designated non-profit functions at which liquor is served, and involve three kinds of fees. Where the occasion is a wedding reception, the fee is $5. For all other occasions where liquor is not sold to the guests the fee is $10. If liquor is sold to the guests at cost, plus a reasonable charge for service, the fee is $10 where the total amount of liquor does not exceed ten bottles of spirits or wine and 120 small bottles of beer, and $15 where the amount is above this limit. Revenue derived from special occasion permits is appreciable, exceeding $850,000 in 1963-64.

54. At their present fee schedules, special occasion permits constitute another element of the alcoholic beverages revenue structure whose rationale eludes us. It is of course reasonable for the province, as a matter of social policy, to regulate the special functions at which liquor may be served. But there is no conceivable basis for extracting general revenue from such regulation. Once again, we believe that the appropriate policy would be to set a single fee sufficient to cover the expenses of the Liquor Licence Board in administering the permits. *We therefore recommend that*:

> ***The fee structure now in effect for special occasion permits be abolished and replaced by a flat fee that will yield an amount not exceeding the administrative costs borne by the Liquor Licence Board in issuing the permits.*** **35:12**

RELATED ASPECTS OF ALCOHOLIC BEVERAGE REVENUE POLICY

55. To round out our treatment of present alcoholic beverage revenue policy, three particular points must be covered. The first involves the miscellaneous revenues of the Liquor Control and Licence Boards, the second the method of accounting followed by the Boards, and the third the question of their administrative and operating costs. The last-mentioned point must necessarily encompass a brief discussion of the respective merits of liquor distribution through state or private stores. To launch our three-pronged discussion, we reproduce in Table 35:9 the Statement of Profit and Loss of the Liquor Control Board of Ontario for the fiscal year 1963-64. Since the Liquor Control Board performs the accounting function for the Liquor Licence Board, the statement represents the operations of both Boards. We have regrouped the items on the income side of the statement under headings that follow the organization of our discussion thus far. Hence the reader may note from the Table the gross profit on sales, slightly under $89 million, the fees and taxes on wine and beer, about $19 million, and the Liquor Licence Act revenue, approximately $7 million.

Other Revenue

56. Two items under the heading "Other Revenue" merit attention. One, the remuneration for collecting Ontario retail sales tax, will vanish as a source of revenue if our recommendation elsewhere in this Report to the effect that vendors' commissions be abolished is accepted. The second is the amount of interest, over $216,000 in 1963-64, earned by the Board on its bank balances. We are somewhat surprised at the large size of this amount, which would indicate that the Board tends to retain funds much in excess of its requirements. We take the view that given the ever-constant cash requirements of the province, surplus moneys should not be withheld from the Treasurer. To permit more efficient handling of the government's cash resources, *we recommend that*:

> ***There be instituted specific procedures for transferring to the Treasury on a regular basis the surplus cash held by the Liquor Control Board of Ontario.*** **35:13**

TABLE 35:9

STATEMENT OF PROFIT AND LOSS, LIQUOR CONTROL BOARD OF ONTARIO, 1963-64

Sales Revenue		
Sales of spirits, wines and beers		$229,543,013.56
Cost of Sales		
Inventories, April 1, 1963	$ 22,433,495.00	
Purchases	136,241,798.99	
	$158,675,293.99	
Less: Inventories March 31, 1964	18,116,813.81	
		140,558,480.18
Gross Profit on Sales		$ 88,984,533.38
Fees and Taxes on Wineries and Breweries		
Ontario wine licence fees and taxes	$ 688,084.19	
Brewers' licence fees	190,800.00	
Beer gallonage taxes	18,303,328.13	
		19,182,212.32
Liquor Licence Act Fees		
Fees on Licensed Premises (Net)	$ 5,340,259.67	
Fines (Net)	197,027.04	
Transfer fees	788,674.32	
Special Occasion permits	857,690.00	
Miscellaneous	1,509.00	
		7,185,160.03
Other Revenue		
Interest on bank balances	$ 216,402.12	
Remuneration for collecting Ontario retail sales tax	126,343.63	
Miscellaneous Receipts	115,398.83	
		458,144.58
Income		$115,810,050.31
Expenses		
Administrative and operating expenses	$ 16,266,354.00	
Furniture, equipment and fixtures, and alterations to owned or rented premises written off	1,031,750.20	
Additions to land and buildings during the year written off	1,365,436.98	
Stock shortages	25,910.06	
		18,689,451.24
Net Income		$ 97,120,599.07

Assets and Depreciation

57. The manner in which the Liquor Control Board accounts for its assets shifts the reader's attention to the Expenses heading of Table 35:9. Here he will note that the Liquor Control Board does not follow the normal business accounting practice whereby fixed assets are capitalized and depreciation written into the

accounts annually to amortize cost over the estimated life of the assets. Instead the Board simply writes off its capital expenditures in the year in which they are incurred, with a consequent distortion of the amount of expenses and hence net revenue compared to what normal accounting procedures would yield.

58. We have attempted to reconstruct Board accounts for the past decade in order to determine the net revenue that would have been realized had assets been depreciated instead of written off. Our calculations were based on the assumption that all Board assets as of March 31, 1953, were depreciated by 50 per cent. Thereafter we applied depreciation at a rate of 5 per cent on buildings and 20 per cent on furniture, fixtures and the like for each year on a diminishing balance. The results are set forth in Table 35:10 which lays out, in order, the Board's operating revenue before depreciation or write-off, our calculation of depreciation, net Board revenue under depreciation, the net revenue actually reported by the Board, and the difference between the two amounts of net revenue. Net revenue under a depreciation method is appreciably higher than the net revenue reported by the Board for all years save 1958-59. This is to be expected in a decade where the Board has had to expand continuously to keep pace with provincial growth. In any event, the determination of net revenue through the practice of depreciating assets will make it possible to judge the Board's financial operations according to criteria that apply to private business.

TABLE 35:10

ESTIMATED NET REVENUE OF THE LIQUOR CONTROL BOARD OF ONTARIO UNDER STANDARD DEPRECIATION PRACTICE, 1953-1964

(millions of dollars)

	Operating revenue before depreciation or write-off	*Depreciation*	*Net revenues after depreciation*	*Net revenue reported by L.C.B.O.*	*Excess (+) or deficit (—) of revenue after depreciation compared to reported revenue*
1953-54	48.5	0.7	47.8	46.0	+1.8
1954-55	48.9	0.7	48.2	46.8	+1.4
1955-56	52.8	0.7	52.1	51.3	+0.8
1956-57	58.5	0.7	57.8	56.6	+1.2
1957-58	70.1	0.7	69.4	66.7	+2.7
1958-59	76.5	0.9	75.6	76.5	—0.9
1959-60	78.3	0.9	77.4	76.9	+0.5
1960-61	82.1	0.9	81.2	80.6	+0.6
1961-62	84.7	1.0	83.7	82.5	+1.2
1962-63	90.6	1.0	89.6	87.5	+2.1
1963-64	99.5	1.0	98.5	97.1	+1.4

59. Two considerations lead us to favour depreciation over the present practice of writing off Board assets. The first is that the Liquor Control Board, whose major role is that of a liquor outlet under government monopoly, should be considered a business from the standpoint of finance and hence follow business methods of accounting. The second is that since Board assets would henceforth

be financed from depreciation reserve and working capital, tighter accounting and budgetary control would likely ensue. *We therefore recommend that*:

> ***In accounting for its assets, the Liquor Control Board of Ontario adopt the depreciation methods that normally apply in private business.*** 35:14

Administrative and Operating Expenses

60. The administrative and operating expenses of the Liquor Control Board of Ontario were $16.3 million in 1963-64. This amount includes Liquor Licence Board expenses and related costs of control. While it is beyond the scope of our terms of reference to undertake an efficiency study of the Board, we consider it appropriate to broach the question of whether lower operating costs, and therefore higher revenue, might be realized if liquor were retailed through private outlets, as it is in a majority of American states. Table 35:11 offers a summary of the financial statements of American private liquor stores for 1964. In that year, store operating expenses averaged 13.2 per cent of sales, with no appreciable variation on the basis of store size. Gross profit, meanwhile, averaged 23.9 per cent of sales. On the basis of these figures, Liquor Control Board operations compare most favourably. The 7.1 per cent relation between Board expenses and sales is half that in private stores, despite the fact that Board figures include not only the combined cost of wholesaling and retailing, but also the cost of control. Were wholesaling costs included in the private store data, operating expenses would probably exceed 20 per cent of sales. As to gross profits, the Board's proportion of 38.8 per cent exceeds the private stores' 23.9 per cent.

TABLE 35:11

SUMMARY FINANCIAL STATEMENT, U.S. PRIVATE LIQUOR STORES, 1964

Item	*Average*	*Up to $50,000 sales*	*$50,000 to $100,000*	*$100,000 to $200,000*
	%	%	%	%
Sales	100.00	100.00	100.00	100.00
Cost of Sales	76.13	77.11	76.26	75.38
Gross Profit	23.87	22.89	23.74	24.62
Total Controllable Expenses	7.22	6.74	6.46	8.43
Total Fixed Expenses (Rent, Utilities, Insurance, Taxes, Depreciation)	5.94	6.84	6.16	5.13
Total Expenses	13.16	13.58	12.62	13.56
Net Profit	10.71	9.31	11.12	11.06

Source: *Expenses in Retail Businesses*, National Cash Register Merchants' Service.

61. While we are unable to produce data that would make possible similar comparisons with regard to beer, we note that the Brewers' Warehousing Company has a ratio of operating expenses to sales of 9 per cent, not far removed from that

of the Liquor Control Board. To the best of our knowledge, no remotely comparable wholesale/retail operation in Canada operates on this low a margin.

62. The compensation for the higher cost and lower profit margins of private stores is presumed to be the public convenience arising from the existence of a larger number of retail liquor and beer outlets. Against this must be pitted three considerations. For one thing, given that adequate numbers of Board and Brewers' Retail stores are established and maintained as a matter of provincial policy, the additional "public convenience" to be gained from more numerous private outlets will be marginal. Then too, multiple private liquor outlets undoubtedly complicate the implementation of socially desirable controls. Finally, there is the fact that a private retailing system yields on the average a much lower return to the public treasury. This fact can be documented from United States data. In that country, liquor is retailed through private outlets in thirty-three states and the District of Columbia, and through government stores in seventeen states. Since the two groups of states represent roughly comparable populations, incomes, rates of alcoholic beverage consumption, and tax and mark-up systems, an approximate comparison is valid. Per-capita revenue for 1962 in the seventeen states with government stores was \$9.78; in the remaining states \$6.70. On balance, then, we have no doubt as to the superiority of public over private liquor outlets. Any future changes in the retailing of alcoholic beverages in Ontario should be modifications of existing methods, not departures from the methods themselves.

ALCOHOLIC BEVERAGES AS A SOURCE OF PROVINCIAL REVENUE: SOME GENERAL CONSIDERATIONS

63. Having made recommendations that will, in our opinion, improve the present revenue system with respect to the sale and control of alcoholic beverages, we must now attempt to come to grips with a more general problem, namely what broad departures, if any, are warranted in alcoholic beverage policy. As a necessary prelude, we must confront three rather technical questions. Who bears the burden of government revenue from alcoholic beverages? What justification can be advanced for raising revenue from this source? What is the nature of consumer demand for alcoholic beverages and its implications for revenue?

THE BURDEN OF REVENUE FROM ALCOHOLIC BEVERAGES

64. In attempting to determine who among consumers and suppliers of capital, labour and raw materials bears the burden of revenue from alcoholic beverages, the nature of supply and demand within the industry is highly important. Because of varying conditions, we believe it useful to distinguish among revenue derived from spirits and beer, wine taxes and mark-up, and liquor licence fees.

Revenue from Spirits and Beer

65. The supply of spirits and beer tends to be fairly elastic—that is, to increase or contract readily with any change in price—in part because the returns to those who supply labour or raw materials are unlikely to be affected by conditions in the brewing and distilling industry. Since labourers employed by the industry are but

a small percentage of the Canadian labour force and are not especially skilled, the industry cannot affect wages significantly. Similarly the raw materials—largely grains—consumed in brewing and distilling are a very small portion of the output of these commodities so that it is unlikely that their price will be affected. Accordingly changes in government revenue policy that affect breweries and distilleries will not tend to be shifted to their suppliers of labour and raw materials.

66. The situation with respect to those who supply capital to the industry differs but slightly. In the short run, capital may have to accept a lower return if, let us say, the Liquor Control Board reduces its purchase price or if a Board increase in mark-up is followed by a decline in consumption. But capital will soon ease out of brewing and distilling until a "going" rate of return is again approximated, thereby leaving investors unaffected by the change in revenue policy. At this point only the consumer remains to bear the burden of a provincial mark-up or beer gallonage tax, and to the extent that his demand is "price inelastic"—that is, remains relatively constant in the face of a price increase—he will absorb virtually the entire burden, this to the point where there is little or no short-run effect on the return to capital. The sustained growth of investment in Canadian distilleries and breweries in the face of several increases in mark-up and taxes merely adds testimony to the fact that the burden of government revenue from alcoholic beverages, and from spirits and beer in particular, tends to be borne by the consumer.

Mark-ups and Taxes on Wine

67. The burden of government revenue from wine sales may have a somewhat different incidence in that the supply of wine tends to be less responsive than that of other alcoholic beverages to changes in price. This is because wineries, unlike distilleries and breweries, consume a large part of the output of their suppliers of raw materials. The consequent impact of conditions in the winery industry on vineyards is enhanced by the fact that vineyard owners cannot readily turn their lands over to the production of other crops. Hence a change in revenue policy, particularly one that reduces the price returned to wineries, is likely to be passed on to the grape growers. If, on the other hand, government raises its mark-up or tax while leaving the return to wineries unchanged, the grape growers will absorb the burden only to the extent that consumer demand falls off. The likelihood of such an outcome is of course reduced to the extent that demand for wine responds little to price changes, so that the consumer assumes most or all of the burden.

Liquor Licence Fees

68. As we have already had occasion to point out earlier in this chapter, the present licensing system for on-premises consumption restricts the number and location of sellers, thereby making it possible for licensed outlets to exact monopolistic profits from their operation. Thus the licensing system itself tends to impose a burden on the consumer and to confer corresponding profits on the seller. If the reasonable assumption is made, however, that a licensed outlet has already taken

advantage of its privileged market position to exact from the consumer a maximum price to yield maximum profits, then the burden of an increase in licence fee will likely be borne by the operator.

THE JUSTIFICATION FOR ALCOHOLIC BEVERAGE REVENUE

69. The burden of government revenue from alcoholic beverages is almost invariably borne by the consumer. To the extent that government is basically in the business of selling alcoholic beverages, the case for a revenue level that would approximate a going rate of return in private industry is unassailable. But government taps alcoholic beverages for revenue clearly in excess of such a going rate of return. What possible justification can exist for so burdening the consumption of a single type of product? Surely this practice constitutes a singular violation of the principle of neutrality in revenue raising.

Social Costs

70. A considerable element of justification for the extraction of high revenue from alcoholic beverages may be found in the appreciable costs that society must bear as the direct and indirect consequences of abusive consumption of these beverages. The costs include not only alcoholism itself, with its adverse effects on personal health and on society, but also crimes and accidents in which alcohol was a principal or contributory cause, serious mental troubles, absenteeism from work, and the like. While it is impossible to arrive at a meaningful dollar valuation of the portion of these social costs imposed upon the government of Ontario, it is none the less certain that their growth has contributed to rising provincial expenditure on traffic control, hospital care and social welfare.

71. Statistics on rates of alcoholism are useful to show the position of Ontario in relation to other Canadian provinces. Table 35:12 provides an historical perspective on rates of alcoholism in Canada and in the three provinces with the highest rates at the present time. The unfortunate progress of Ontario over the last two decades is striking. Before World War II, the alcoholism rate in Ontario was

TABLE 35:12

RATES OF ALCOHOLISM IN CANADA AND SELECTED PROVINCES, 1939-1961

(Alcoholics per 100,000 people aged 20 or over)

	Canada	*Ontario*	*Quebec*	*British Columbia*
1939	1,210	1,095	1,780	1,305
1946	1,320	1,150	1,820	1,650
1949	1,540	1,545	1,790	1,880
1955	1,750	1,900	1,910	2,190
1961	2,140	2,440	2,340	2,380

Sources: R. E. Popham and W. Schmidt, *Statistics of Alcohol Use and Alcoholism in Canada 1871-1956*, pp. 116-18, and *Statistics of Alcohol Use, Alcoholism and Drug Addiction, Canada and Provinces, 1962*, compiled by R. S. Bennett, reprinted from the thirteenth annual report (1963) of the Alcoholism and Drug Addiction Research Foundation of Ontario, p. 13.

exceeded by the rates for Canada as a whole and British Columbia, and more considerably by the rate in Quebec. By the end of the War, little change had occurred, but in the next fifteen years the Ontario rate more than doubled. By 1949 Ontario had caught up with the Canadian rate, by 1955 with Quebec, and in 1961, it led the nation with 2,440 alcoholics for every 100,000 persons aged twenty years or over.

72. While alcoholism must be acknowledged as a growing problem in Ontario, we do not believe that the consumption of alcoholic beverages can be effectively, let alone equitably, controlled by prime reliance on pricing. To the extent that more stringent control should become government policy, more direct measures than price changes would be required. In the present context, the important point is that the extraction of substantial revenue from alcoholic beverages can find a measure of justification in the social costs of drinking, costs which, as alcoholism rates testify, give every evidence of rising. Admittedly, the uninhibited extraction of provincial revenue from alcoholic beverages may ultimately increase the very social costs it is designed to recoup, for example, by making the "problem drinker" a clearly insufferable burden on his family. Continuous research on the intricate relationship between social costs and pricing policy is therefore mandatory.

Social Policy

73. Social costs by no means offer a completely satisfactory justification for a situation where the provincial government derives seemingly ever higher revenues from liquor. For one thing, the social costs of drinking, however high, far from accruing in their entirety to the Province, probably impinge more seriously on other parties—businesses and individuals, for example—who have no means of recouping their losses. Then too, and perhaps more important from the standpoint of equity, many drinkers of alcoholic beverages—undoubtedly the majority—create no social costs whatsoever. But these considerations notwithstanding, it can be readily observed that there exists a deep-seated consensus to the effect that the very availability of alcoholic beverages, together with the attendant social costs, however imprecise their level or allocation, justifies the extraction of substantial government revenue. We have taken pains at the outset of this Report to point out that social policy based on broad popular consensus may occasionally in a democracy override such principles as those of neutrality and equity. With immediate reference to alcoholic beverages, we do not believe that social policy can justify a basically arbitrary pattern of revenue-raising and we have already made recommendations that we trust will make this pattern more rational and equitable. We do not pretend, however, that existing levels of provincial revenue from alcoholic beverages can be defended in terms of equity. The fact is that these levels have long been generally accepted and have come to occupy an important place in the Ontario revenue structure. Until such time as more equitable sources of revenue can be developed to assist in meeting the Province's rapidly growing financial requirements, we see no alternative to a continued heavy reliance upon revenue from the sale of alcoholic beverages.

74. At this juncture it is worth noting that social consensus in other Canadian provinces tolerates a revenue burden on alcoholic beverages substantially higher than that which obtains in Ontario. Table 35:13 offers a summary of provincial mark-ups at February 1, 1967 in seven Canadian provinces for three standard items—medium-priced rye whisky, Canadian dessert wine and Canadian beer, the last broken down to show revenue from beer sold through government stores and, where applicable, through private vendors. Ontario's percentage of mark-up is lower in every instance than that in other provinces, particularly so for wine and beer. We doubt that the exclusion of three provinces alters the validity of this observation, since in 1964, a year for which we had complete information for all provinces, the relative position of Ontario was identical. To the extent that social consensus in Ontario partakes of that in Canada generally, there may well exist in this province latent sanction for yet higher alcoholic beverage revenue.

TABLE 35:13

COMPARATIVE PROVINCIAL MARK-UPS ON ALCOHOLIC BEVERAGES FEBRUARY 1, 1967

	Rye whisky medium-priced	*Canadian dessert wine*	*24 Bottles (12 oz.) of beer*
	Per cent of cost	*Per cent of cost*	*Per cent of cost*
Newfoundland	105.0	154.0	42.9 (Govt. stores)
Prince Edward Island	81.5	111.7	60.3 (Govt. stores)
New Brunswick	100.0	123.6	66.3 (Govt. stores)
Nova Scotia	81.7	94.4	60.0 (Govt. stores)
Ontario	77.9	61.3	26.6 (Govt. stores)
			11.2 (Brewers' stores)
Manitoba	90.0	90.0	40.8 (Govt. stores)
			31.6 (Vendors)
Alberta	102.1	86.4	37.1 (Govt. stores)

Source: Figures were supplied by the various provincial liquor boards.

Notes: 1. The brands taken as examples are: Gilbey's Black Velvet, Brights Hermit Sherry and Carling's Red Cap, or near equivalent.

2. In sales by stores other than government stores, the mark-up excludes any operating costs the liquor boards would have borne had they sold directly to consumers.

3. The liquor boards of Quebec, Saskatchewan and British Columbia did not supply comparable data.

CONSUMER DEMAND AND ALCOHOLIC BEVERAGE REVENUE

75. Where social consensus supports the extraction of substantial revenue from alcoholic beverages, it is still necessary to ask what impact changes in consumer price will have on revenue. This is because a distinction must be drawn between the level of mark-up and revenue on the one hand, and the total amount of alcoholic beverage revenue on the other. Thus a large rise in mark-up need not necessarily increase total liquor revenue; for example, the total revenue effect of a higher mark-up could be nil if the quantity of spirits consumed declined sufficiently in reaction to the higher price. The problem is one of the price elasticity of demand—that is, of the relation between the price of alcoholic beverages and the quantity consumed. A closely related problem, particularly evident over the longer

run, is that of the *income* elasticity of demand. In other words, changes in income can nullify or accentuate the impact of changes in price on the amount of liquor consumption.

76. There exists no empirical evidence of the price or income elasticity of demand for alcoholic beverages in Ontario. The Liquor Control Board has unfortunately never produced any serious study of the impact of price and income changes on the demand for its products. Lacking any reliable estimates for Ontario or Canada, we have turned for guidance to the United Kingdom and the United States, where studies of the price and income elasticities of the demand for liquor have been undertaken with some care.

United Kingdom Experience

77. Estimates for the United Kingdom for the period 1920-1938, calculated by the Department of Applied Economics, Cambridge University, indicate that when the price of spirits changed, all other things remaining the same, the volume of spirits consumed tended to change in the opposite direction, but less than proportionally to the change in price. In particular, when the price increased by 10 per cent, the quantity consumed declined by about 7 per cent, indicating a somewhat inelastic demand for liquor in relation to price. For beer, the relation was basically the same, except that the change in quantity, about 9 per cent, was slightly greater than for spirits, the demand nevertheless being slightly inelastic. For wine, the results of the research were inconclusive.

78. With respect to changes in consumer income, the United Kingdom study found that changes in consumption of spirits and wine were in the same direction. They were somewhat less than proportional for spirits, indicating an inelastic demand in relation to income, and slightly more than proportional for wine, indicating in this instance an income-elastic demand. For beer, the results were inconclusive.[4]

United States Experience

79. Estimates for the United States for the periods 1934-1941 and 1947-1960 indicate a much greater response to a change in the price of spirits than in the United Kingdom. An increase in price of 10 per cent was accompanied by a much more than proportionate decrease in consumption of about 20 per cent, reflecting a much higher price elasticity than in the United Kingdom. It seems that in the United Kingdom, a substantial shift from spirits to beer has occurred over the last few decades, restricting the consumption of spirits mainly to the higher income groups whose response to price changes is relatively slight, at least up to a certain price level. On the other hand, in the United States, the increase in the price of spirits over the years has carried the price to such a level that the consuming public[5] has become very sensitive to price changes. This is partly because liquor

[4] R. Stone, *The Measurement of Consumers' Expenditure and Behaviour in the United Kingdom 1920-1938*, Vol. I, Cambridge University Press, 1954, pp. 178-9, 388-90.

[5] In the late 1950's, over 40 per cent of the alcohol consumed in the United States was contained in spirits. In the United Kingdom, the percentage was only 15.

claims a rising part of the average family's income and partly because substitute forms of social expenditure become more attractive when liquor prices are high. For beer and wine, on the other hand, the estimates for the United States are closer to those for beer in the United Kingdom; an increase in price is followed by a smaller proportionate decrease in quantity.[6]

80. As to the response of demand to changes in consumer income, the estimates for the United States are not very different from those for the United Kingdom: the change in the consumption of spirits and wine is in the same direction, less than proportional to the change in income for spirits and proportional for wine. Beer, on the other hand, reveals a quite different situation: an increase in income of 10 per cent was found to be followed by a decline of 3 per cent in the quantity of beer consumed. A similarly negative relationship has been observed also in other countries, reflecting the desire of drinkers, as their incomes rise, to switch from the consumption of beer to more expensive substitutes.

81. The important points that seem to emerge from these and other studies are the following. The price elasticity of demand for spirits, being the ratio of the proportional change in quantity purchased to the proportional change in price, may be smaller than unity, as in the United Kingdom, or it may rise to well above unity, as in the United States. It tends to vary with the level of price, being greater at higher price levels. Elasticity also tends to vary with the income of the consumer, being smaller among higher income groups. It varies also with the rate at which price is changed. A 20 per cent change in price spread in small instalments over a period of time will have different effects on consumption than will a lump change of 20 per cent. Another significant observation is the negative response of beer drinkers to an increase in incomes. After a certain level of income has been reached, they tend to reduce their consumption of beer and increase their consumption of spirits and wines.

Implications for Ontario

82. What conclusions may be drawn for Ontario from the foregoing findings? The volume of spirits consumed per adult, in terms of absolute alcohol, is smaller in Canada and in Ontario than the average for the United States;[7] but personal disposable income per head also is lower.[8] Putting these factors together, and also taking into account certain similarities in the consumption patterns of Canadians and Americans, one might expect that further increases in the prices of spirits from their present levels will be followed by a more than proportional decline in the quantity consumed. (It has been noted that the initial reaction to a price increase is a switch to a lower-grade product.) In so far as a change in the price of beer is concerned, one might expect that an increase in price would tend to be followed by a less than proportional decline in consumption.

[6]W. A. Niskanen, *The Demand for Alcoholic Beverages, an Experiment in Econometric Method*, The Rand Corporation, May, 1962, mimeo, pp. V, 31, 39, 41-2.

[7]The consumption of absolute alcohol in spirits per adult (fifteen years and older) in Ontario in 1961 was .57 Imperial gallons. In the United States in 1959, it was .65 (based on data in Alcoholism and Drug Addiction Research Foundation, *Statistics of Alcohol Use and Alcoholism in Canada 1951-1961, Second Report*).

[8]In 1962, it was $1,513 in Canada, $1,733 in Ontario, and $2,069 in the United States.

83. With change in income, one might expect that an increase in income will be followed by an increase in the consumption of spirits and wine, as in the United Kingdom and the United States, and a decline in the consumption of beer. Of course, other concurrent changes—for example, a large inflow of immigrants—can substantially modify the results to be expected from a change in income alone.

Elasticity and Revenue

84. At this juncture we may focus our attention entirely on revenue. Here it is useful to distinguish between the price elasticity of demand, and the mark-up or revenue elasticity of demand. The price of an alcoholic beverage may change owing to a change in either the manufacturer's price or the tax or mark-up. If we assume, for the sake of simplicity, that manufacturers do not change their price when the government or its agency raises the tax or mark-up, the change in total price will be proportionally smaller than the change in tax or mark-up. It follows that the ratio of the percentage change in quantity consumed to the percentage in tax or mark-up will be smaller than the ratio of the percentage change in quantity consumed to the percentage change in price—that the tax or mark-up elasticity of demand is smaller than the price elasticity of demand. This principle is demonstrated in Table 35:14.

TABLE 35:14

MARK-UP CHANGES AND SELLING PRICES: A HYPOTHETICAL EXAMPLE

	Existing price	*New price*	*Change*	*Volume sold at existing price*	*Volume sold at new price*	*Consumer expenditure at old price*	*Consumer expenditure at new price*
Selling price	100	120	+20%	100	75	10,000	9,000
Manufacturer's price	60	60	——				
Mark-up	40	60	+50%				

A 50 per cent increase in mark-up gives a 20 per cent increase in price. The ratio of percentage change in quantity consumed to percentage change in price is 25:20 or 1.25, while the ratio of percentage change in quantity consumed to percentage change in mark-up is 25:50 or 0.50. The total mark-up revenue increases then from $40 \times 100 = 4{,}000$ to $60 \times 75 = 4{,}500$.

85. It follows, then, that even if the price elasticity of demand in Canada is greater than unity, as it is in the United States, the tax or mark-up elasticity of demand may be smaller. All will depend on the proportion of the final price that consists of the tax or mark-up: the smaller this proportion, the greater the difference between the tax or mark-up elasticity of demand and the price elasticity. Since the provincial share in the final price is not more than about two-fifths, the tax or mark-up elasticity of demand may well be substantially less than unity. In terms of the relation of a change in tax or mark-up to change in provincial liquor revenue, which is the main concern in the present discussion, it would seem that an increase in the rate of provincial tax or mark-up of the Liquor Control Board,

with the manufacturer's price and federal taxes remaining the same, may still result in an increase in the total provincial liquor revenue. With respect to beer, matters are simpler. Since the price elasticity of demand is smaller than unity, the tax or mark-up elasticity will be smaller also and hence result in higher provincial revenue.

GENERAL RECOMMENDATIONS

86. We have seen that the burden of revenue from alcoholic beverages is borne almost exclusively by the consumer. The justification for extracting large amounts of revenue is to be found partly in the social costs of drinking, partly in social consensus. That the consensus is widely shared can be observed throughout Canada, to say nothing of other countries, and indeed other Canadian provinces place higher revenue burdens on the consumers of alcoholic beverages than does Ontario. Given the lower price levels and the higher incomes in Ontario, together with the existing pattern of demand for alcoholic beverages, it is apparent that further increases in taxes and mark-up are very likely to yield higher revenue.

87. If nothing else, our research has impressed us with the complexity of relating the level of demand for alcoholic beverages to prices, personal income and revenue. It is true that past increases in mark-up have never failed to yield higher revenue to the Province. But the haphazard guesswork of the past is becoming less reliable with each increase in prices. *We therefore recommend that*:

> ***The Liquor Control Board of Ontario be directed to institute a program of continuing research into the revenue and other effects of changes in the prices of spirits, wine and beer.*** **35:15**

88. Ever since the demise of prohibition, one of the acknowledged objectives of the Ontario government with respect to alcoholic beverages has been that of control. Rising rates of alcoholism hardly suggest that this facet of alcoholic beverages policy should be allowed to recede to a place of secondary importance. Having in mind the twin goals of revenue and control, we believe that the government should undertake careful study of the feasibility of pricing alcoholic beverages according to their absolute alcoholic content. By relating price to alcoholic content by volume, the government might encourage the consumption of generally less intoxicating beverages. It will have taken an important step in this direction by accepting our recommendations that discrimination in favour of domestic products be brought to an end.

89. While the research studies which we have undertaken indicate that the problem is rather complex, it may well be feasible to adopt some form of price bracketing that would establish minimum price levels on the basis of alcoholic content—for example, $4.00 per bottle for spirits, $2.00 per bottle for dessert wines, $1.25 per bottle for table wine, and $3.50 per case of twenty-four small bottles of beer. Prices would be scaled upward from these minima depending upon suppliers' prices.

90. A liquor pricing policy based upon alcoholic content could have desirable control effects without sacrificing revenue. Such a policy would result in placing the highest price on spirits, the second highest price on dessert or fortified wines, a lower price on light table wines, and the lowest price on beer. With respect to the favourable price treatment which such a system accords to beer, we note that all studies on alcoholism agree that very few alcoholics are to be found among beer drinkers. Accordingly, *we recommend that*:

> ***The Government of Ontario, through the Liquor Control Board of Ontario and the Alcoholism and Drug Addiction Research Foundation, seriously study the feasibility of establishing a price structure that would take as its primary basis the alcoholic content of different types of alcoholic beverages.*** **35:16**

91. In that the provincial government maintains a policy of looking to alcoholic beverages as a means of meeting its growing fiscal needs, we feel bound to point out that it is far from alone in this revenue field. In 1963-64 federal revenue from alcoholic beverages sold in Ontario exceeded by a considerable margin the $107 million, including retail sales tax, derived by the province. Composed of $67 million in customs and excise duties, $59 million from malt duties and taxes on domestic beer and wine, and $13 million in manufacturers' sales taxes, federal revenues on Ontario sales were $139 million. In this situation where the federal government is indeed the major occupant of the alcoholic beverages revenue field, there is the danger that changes in federal revenue policy might well cancel out carefully determined changes in provincial pricing unless appropriate co-operation between the governments is achieved. We therefore wish to suggest the need for measures to co-ordinate federal and provincial action. Accordingly, *we recommend that:*

> ***Representations be made to the federal government for closer federal-provincial co-ordination of revenue policies relating to alcoholic beverages.*** **35:17**

Chapter 36

Provincial Government Enterprises

INTRODUCTION

1. In the course of meeting the challenges generated by an increasingly sophisticated economy, governments have found it necessary to engage in a number of activities that are basically commercial in nature. Although the best-known examples of government enterprise in Canada are under federal aegis, the provinces, and for that matter their municipalities, carry on many, frequently extensive, business operations. Workmen's compensation boards and liquor commissions, treated elsewhere in this Report, are examples common to all provinces. Next in popularity come electric power commissions, which can now be found everywhere except in Prince Edward Island. In addition, there exists an imaginative variety of other enterprises, ranging from railways to telephone systems and from lending agencies to bridge authorities. With the exception of the liquor commissions, which everywhere return generous sums to provincial coffers, there are few enterprises that contribute profits directly to the Consolidated Revenue Fund, except in Saskatchewan. In that province, public enterprises have been remitting sums that approximate one-quarter of the returns from the control and sale of liquor.

2. No other province has chosen to absorb public enterprise profits for revenue purposes, although this situation might possibly change as certain provinces consolidate recent acquisitions of power companies. The provinces concerned have so far chosen to allow their power corporations to retain profits for expansion. Ontario conforms closely to the general rule—in fact most of its public enterprises are specifically charged to provide service at cost, and are not expected to contribute to provincial revenue.

3. There is, of course, nothing in the nature of government enterprises that inherently precludes their making profits. But the raising of revenue or, for that matter, the provision of employment, only occasionally leads governments into business activity. In the main, governments enter the field of enterprise for one or a combination of the following three reasons: first, the unattractiveness of a particular operation to private firms or their failure to provide services at a level deemed commensurate with the public interest; second, the goal of making services available at a rate lower than the prevailing commercial rate; third, certain social benefits that may potentially accrue from the public operation of certain industries.

THE PUBLIC ENTERPRISES OF THE PROVINCE OF ONTARIO

4. As a general proposition, there is little doubt that the main motive that has led Ontario to undertake its commercial enterprises is that of providing services that either would not be undertaken by private interests or can be better provided by government. The following list of the major enterprises yields a picture of the diversity and importance of their operations.

(1) The *Hydro-Electric Power Commission of Ontario* generates, imports and distributes about nine-tenths of the electric power used in the province.

(2) The *Ontario Northland Transportation Commission* and its subsidiary, *Star Transfer Ltd.*, run a railroad and trucking service in the northeastern part of the province, where population is sparse and access limited.

(3) The *Ontario Food Terminal Board* and *Ontario Stock Yards Board* provide the physical facilities and associated services for the marketing of certain agricultural products.

(4) The *Ontario Water Resources Commission* constructs and operates sewage and water facilities under agreements with municipalities.

(5) The *Niagara Bridge Commission* and *Niagara Parks Commission* operate international bridges and parks and other facilities in the Niagara area.

(6) The *Sheridan Park Corporation* through a land assembly program is developing a large research community in conjunction with private enterprise.

(7) The *Province of Ontario Savings Office* operates a savings bank through twenty-one branch offices.

5. Most of these enterprises are under statutory prescription to provide services at cost. Although what constitutes "cost" is rarely defined in detail, neither profits

nor losses arise in most of the enterprises. It might be noted, however, that the Ontario Northland Transportation Commission operates at a loss. On the other hand, the Province of Ontario Savings Office produces a net financial benefit to the government in that it makes funds available at a cost substantially below prevailing long-term rates of interest. For the rest, Ontario public enterprises maintain themselves on revenues derived from the provision of service at cost, in keeping with the deliberate intent of the Legislature at the time they were established. Legislative policy underscores the traditional view of successive Ontario governments that any service that can be rendered in an economically efficient manner should be left to private enterprise unless there exist overriding social considerations to the contrary. This view is generally shared by other provinces, but there are exceptions—notably Saskatchewan—that have resulted in the use of enterprises as a means of raising revenue.

6. In addition to operating the service types of enterprise just discussed, the Province of Ontario lends money for diverse purposes to a variety of organizations and individuals. This is frequently but not necessarily done through the device of separately established lending corporations, of which the Ontario Junior Farmer Establishment Loan Corporation, the Ontario Municipal Improvement Corporation, the Ontario Universities Capital Aid Corporation, and the Ontario Education Capital Aid Corporation are the leading examples. Occasionally, loans are administered directly by an existing department or commission, as with the hospital construction loans of the Ontario Hospital Services Commission, and the co-operative and tile drainage loans of the Department of Agriculture.[1]

7. Again, various agencies are empowered not only to make outright loans but also to guarantee borrowings for a number of purposes. These include the Ontario Housing Corporation in the field of housing, rehabilitation and redevelopment, the Student Aid Branch of the Department of University Affairs, which administers the Canada Student Loan Plan, and the Ontario Development Agency, which guarantees loans to Ontario businesses that demonstrate ability to contribute significantly to provincial economic growth.

8. No picture of provincial lending and guaranteeing activities is complete without mention of the miscellaneous loans, some of considerable size, that the Province has made from time to time to its own public enterprises, to such other public bodies as the University of Toronto, and to certain municipalities. There exist as well heavy contingent liabilities undertaken through provincial guarantee of the bonds and debentures of such public enterprises as The Hydro-Electric Power Commission of Ontario and the Ontario Northland Transportation Commission.

9. A noteworthy outcome of provincial lending activity is that the government receives substantial income from interest payments amounting to over $20 million

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[1]In addition to the loan programs just mentioned, there are at least three—Settlers Loans, Commissioner of Agriculture Loans and Housing Corporation Ltd. Loans—that have expired and whose remaining activity involves the collection of sums still outstanding.

annually. While interest payments are treated as reimbursement of expenditure and deducted from the expenses of maintaining the public debt, they are readily identifiable in the Public Accounts. What cannot be pinpointed, however, is the cost involved in making loans, in part because loans are normally administered as a subsidiary part of a broader government program. While it is thus impossible to tell precisely whether or not interest payments fully reimburse the government for its lending costs, it is likely that they enable the Province to recoup at least a substantial part of the expenditure. In any event, the question of cost is somewhat academic since loans are made as part of a deliberate policy to supplement the resources of the private sector of the economy and to make available money at a reasonable rate of interest to those who would otherwise have difficulty raising funds for what are deemed to be socially desirable purposes.

THE NEED FOR A REVIEW OF PROVINCIAL ENTERPRISES

10. We have already discussed the three principal reasons that have impelled the government of Ontario to engage in public enterprise—the unattractiveness of a particular endeavour for private firms, the desire to make available services for less than prevailing commercial rates, and the social benefits that may arise from public operation of certain industries. We do not deem it appropriate to become embroiled in a detailed debate over the merits and demerits of public enterprise because the issues at stake in such a controversy are not primarily issues of revenue. Were it indeed the case that public enterprises constituted a significant source of general revenue, we could not in our opinion devise a comment more appropriate than that of the Saskatchewan Royal Commission on Taxation:

> Beyond the provision of "service at cost" the rate charges of a publicly owned utility become, in fact, a tax. There is a *prima facie* case against using public utilities in this fashion, quite apart from the fact that to do so is to deny in part the very reason for their existence. A tax of this type conforms to few of the accepted canons of taxation except that it is stable, collectable and enforceable (at the price of denying someone what may be an essential service). Again, it is capricious in its impact, depending, in the case of basic utilities at least, upon factors which have nothing to do with ability to pay. It is also likely to be regressive in that rate scales when viewed as tax schedules are usually loaded against the small consumer, the one who is least likely to be able to afford the tax.[2]

11. It is a matter of sound practice for all organizations, governments no less than others, to make periodic examinations of their operations. We are convinced that this practice should be applied to the business activities of the Province, and in particular we think that each government enterprise should be considered in the light of its nature, objectives, policies and practices. It may well be, for example, that the circumstances that surrounded the creation of a public enterprise have changed. Thus instructing the enterprise to operate at cost, or at a certain definition of cost, though valid initially, may be inappropriate at a later point in time.

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[2]Saskatchewan, Royal Commission on Taxation, *Report,* Regina, 1965, p. 62.

12. Similarly, periodic review should help to ensure that a government enterprise is actually fulfilling its mandate. This will require, among other things, an examination of the accounting practices of the enterprise to ensure that the reported results correspond to generally accepted practice. Lest anyone think that accounting practices are a marginal consideration, we would like to mention one example that has come to our attention during the course of our inquiry.

13. The Hydro-Electric Power Commission is the largest of the Ontario Crown corporations, if indeed it can be called a Crown corporation at all. It was established by provincial statute in 1907 to supply power to a group of municipalities in southwestern Ontario at the initial behest of local businessmen. Since then the Commission has expanded its activities enormously and is now responsible for about 90 per cent of all the power produced or sold in the province. It has never, in the nearly sixty years of its existence, reviewed its original format—that of a unique hybrid between a municipal co-operative and a provincal Crown corporation. One implication of the present status of Hydro is that its accounts show that the municipal utilities it services have an equity in the Commission.

14. Under the provisions of The Power Commission Act[3] the price payable for power by a municipal corporation is the "cost to the Commission" of supplying and delivering power to the municipal corporation. Included in the calculation of cost for purposes of billing are three amounts that under generally accepted accounting practice would not be considered to be cost. Taken together, these three items increased the calculated cost of primary power allocated to Commission customers—mainly but not exclusively municipal electric utilities—by over $41 million in 1965 and $32 million in 1964, or over 13 per cent and 11 per cent, respectively, of the amounts actually billed.

15. The statutory authority for reflecting two of these three amounts in determining cost is quite clear. First, Section 78 of The Power Commission Act provides that, in addition to depreciation "of the works", there shall be included in cost an annual sinking-fund provision sufficient, over a forty-year period, with interest at 4 per cent per annum, to retire the indebtedness of the Commission in respect of the cost of the works as well as to restore "any reserve or other funds of the Commission utilized for the payment of the cost of the works". Second, Sections 16 and 78 of the Act provide authority for (1) increasing or reducing cost by such an amount as the Commission determines should be added to or withdrawn from a reserve for the stabilization of rates and contingencies, and (2) the inclusion in cost of interest on the balances remaining in this reserve at rates the Commission deems equitable and just.

16. The statutory authority for including at least part of the third amount in the cost of power is less clear. It is the practice of the Commission to charge cost with interest at 4 per cent per annum on the contributed capital represented by equities accumulated through sinking-fund provisions and interest. To the extent that sinking-fund moneys are used to meet the cost of capital works or

[3]R.S.O. 1960, c. 300, s. 78.

to retire debt other than at maturity of funded debt, they are not available for investment in income-earning securities. It is therefore necessary to charge to cost 4 per cent interest on the uninvested part of the funds if the sinking fund at the end of forty years is to be sufficient to retire the debt. So, whether there is express statutory authority or not, if it is desirable to include the sinking-fund provision in cost, it is also desirable to include in cost interest on the fund until such time as the accumulated sinking-fund provision and interest in respect of the cost of a work are equivalent to the amount borrowed for that work externally (through security issues) or internally (from reserves).

17. The pricing policies established by The Power Commission Act and Hydro are in effect similar to those of the municipal electrical utilities that pay for some part of their capital needs from accumulated net income. Elsewhere in this Report, we indicate that we favour moderate financing of local government capital needs from current revenue. However, we think that the amount of capital expenditures so charged should be disclosed fully in the financial reports. It is our view that consideration should be given to changing The Power Commission Act, together with the present practices of Hydro, so as to arrive at the cost of power in accordance with generally accepted accounting practices, and to bill the municipalities at such cost plus a profit margin not exceeding a specified percentage of cost. We think that a profit margin in the range of 5 to 10 per cent of cost would be appropriate. This would for all practical purposes have the same effect as is now achieved by including in the cost of power the three non-cost amounts described in the preceding paragraphs. The Commission would then show a profit from its operations which it could appropriate for debt retirement, for the reserve for rate stabilization and contingencies, or to finance expansion of its capital works as it saw fit. We see no reason why the applicable portion of amounts appropriated for debt retirement or to finance capital works should not be allocated to the equities of the municipalities and the rural power district in the same manner as at present. *We therefore recommend that:*

The Power Commission Act be amended **36:1**

(a) to define cost of power so as to be consistent with generally accepted accounting practices, and

(b) to require billing at cost plus a profit margin not exceeding, except with the approval of the Lieutenant Governor in Council, a specified percentage of the cost.

18. In summary, then, we have found that the financial structure and past reports of Hydro have been such that they have not made entirely clear the particular status of this large and successful enterprise. Over the years, through the inclusion in cost of sinking-fund provisions and interest, Hydro has been able to accumulate "contributed capital" until it now approximates $550 million, of which nearly $400 million has been allocated to municipalities and $97 million to the rural power district. Most of this amount has been utilized either to finance a portion of capital expenditure without recourse to external borrowing or to retire debt previ-

ously incurred for capital expenditure, and rather than being treated as municipal equity, it might have been considered to be the equity of the Commission resulting from the practice of charging customers a limited amount of profit to finance debt retirement and annual capital expenditure. The treatment given, however, more closely reflects the concept that Hydro is at least partially a co-operative enterprise of the municipalities, the retained profits from which represent their equity.

19. Other findings with respect to Hydro raise the question of whether similar problems may beset other government enterprises. Notwithstanding the fact that we did not subject them to individual study, we are convinced that a systematic review of all provincial enterprises is needed to ensure that each is in fact continuing to perform a necessary function under instructions suited to present circumstances, although it is probably beyond our terms of reference so to recommend.

THE TAXATION OF PROVINCIAL ENTERPRISES

20. That provincial enterprises should be liable for all municipal and school taxes is a cardinal point of our philosophy, and we have so recommended elsewhere in this Report. We approvingly note also that the Province itself has held its enterprises liable for such expenditure taxes as those on retail sales and gasoline. The payment of provincial expenditure taxes and of full municipal and school taxes constitutes an entirely legitimate expense of doing business in the province, and should be an integral part of any definition of providing "service at cost".

21. There remains the question of whether provincial enterprises should be assessed federal and provincial income taxes. It is again part and parcel of our fiscal philosophy that such enterprises should be taxed on their "taxable income" as defined in the federal Income Tax Act and the Ontario Corporations Tax Act. We doubt, however, that very much revenue would accrue to either Ontario or Canada from imposing income tax on provincial enterprises, and this for two reasons. First, to use what is by far the most important provincial enterprise, Hydro, as our example, the capital cost allowances under the federal and Ontario Acts would likely exceed the amounts of depreciation provided in the Hydro accounts by a margin more than sufficient to offset the "profit" the Commission now makes by charging customers for sinking-fund provisions, rate stabilization and contingency provisions, and interest on the accumulation thereof, which items are not allowable for income tax purposes. Therefore Hydro in all probability would have no taxable income. Second, since a government-owned utility, unlike a privately owned business, is able to borrow all of its capital requirements other than what is financed through accumulated reserves and earnings, it would be able for income tax purposes to deduct interest on all the capital raised through security issues. A private enterprise, for its part, must finance a portion of its needs by the issue of shares of capital stock on which it pays dividends, which are not deductible from income for tax purposes. Thus, even though a government utility is in all other respects the exact equivalent of a privately operated utility, it will have a smaller taxable income. We note that in the United Kingdom electricity and gas boards are subject to income tax although it is likely that some years will elapse before they have taxable incomes. Hence, while we doubt that the taxation of the

"profits" of government-owned enterprises would yield very much revenue, we nevertheless believe that they should be liable for income as well as other taxes. *We therefore recommend that:*

Government-owned business enterprises be subject to income taxes under the Ontario Corporations Tax Act. **36:2**

DEBT GUARANTEES AND PROVINCIAL ENTERPRISES

22. It has been the practice of the Province to guarantee most of the debentures of its enterprises, and occasionally to borrow directly on their behalf in the United States. Direct borrowings have been relatively small, but debenture issues of provincial enterprises have been guaranteed regularly and frequently. At March 31, 1965, the outstanding contingent liabilities of the Province from guaranteed debt amounted to $1,754 million, of which $1,729 million represented bonds of The Hydro-Electric Power Commission. The remainder was divided between the Ontario Northland Transportation Commission and such other varied beneficiaries as the University of Toronto. Guaranteed debt is an enormous contingent liability for the Province to undertake, being only slightly less than the $1,900 million in provincial bonds and stocks held by the public.

23. It is virtually impossible to calculate the precise effect of guaranteeing debt, either on provincial credit or on that of Hydro and the other enterprises to which guarantees are extended. In our opinion, however, a good case can be made in general terms for discontinuing the practice of guaranteeing the debt of major provincial enterprises. In the first place, inasmuch as guarantees are generally deemed to diminish the over-all credit of the Province, it is likely that they lead to a somewhat higher interest rate on provincial bond issues than would otherwise prevail. To the extent that this is so, all taxpayers are penalized in order to benefit the customers of provincial enterprises, chiefly electricity users. Second, it is by no means certain that a provincial guarantee will necessarily produce an interest rate lower than a provincial enterprise can itself command. There are several instances in the United States of authorities that operate public utilities enjoying interest rates lower than those paid by the states whose creatures they are. Finally, and precisely in so far as the cost and benefit of guarantees cannot be determined, it can be said that the practice of offering them further muddies the already opaque waters of public finances in Ontario. In our view, the Province should discontinue guaranteeing the debentures of any enterprise whose nature is such that it can reasonably be expected to meet the competitive tests of the capital market. *We therefore recommend that:*

The Province consider discontinuing its practice of guaranteeing the securities issued by those public enterprises whose offerings can be sold readily in the open market on acceptable terms. **36:3**

Chapter 37

Other Non-Tax Revenues

INTRODUCTION

1. Each year the Public Accounts of Ontario list hundreds of revenue items that result from issuing licences, performing inspections, providing facilities, selling surplus or commercial goods, and the like. Certain of these non-tax revenues have been dealt with elsewhere in this Report, inasmuch as they are part and parcel of major revenues. Treated in this manner, for example, are the fees collected from owners and operators of motor vehicles, and annual corporate filing fees. Water-power rentals, fire protection charges and hunting licences are dealt with in the appropriate chapters on natural resources, and all revenues arising from the sale and control of alcoholic beverages, including licences, are discussed together. Here we treat the heterogeneous farrago of items, mostly small in themselves, that accrue almost incidentally from the operations of government.

2. The variety of these revenues reflects the diversity of government activity itself, making generalizations difficult. It is almost, but not quite, safe to say that all departments of government have some incidental non-tax revenue. At least the Public Accounts for 1964-65 reveal only two exceptions to this rule—the Department of Civil Service and the then fledgling Department of University Affairs. But

each of the nineteen remaining departments reveals some contribution to the public treasury, including the Department of Prime Minister, which duly notes a 1964-65 total of $57.29—$38.00 from sales of orders-in-council and $19.29 from miscellaneous sources. While the diversity of these contributions staggers the imagination, some rough classification can be attempted to make discussion meaningful.

3. Miscellaneous non-tax revenues have always enjoyed a degree of importance in the provincial public accounts, although their relative position has followed a downhill course virtually since the time of Confederation with every major tax addition to the revenue system. In 1964-65, the assorted earnings of provincial government departments were approximately $39 million. While these items accounted for little more than 3 per cent of net ordinary revenue, they approached the $48.7 million collected that year in succession duties. Table 37:1 offers a summary of non-tax revenues grouped under four headings—service, licence and permit fees; sales and rentals; fines and forfeitures; and miscellaneous. Fees constitute the largest single category, amounting to $20.5 million or 53.2 per cent. Sales and rentals are next in order of importance, totalling $14.1 million or 36.6 per cent. Fines and forfeitures, at $2.9 million or 7.5 per cent, and miscellaneous others, $1.1 million or 2.7 per cent, round out the picture. We shall proceed to examine these categories in turn.

SERVICE, LICENCE AND PERMIT FEES

4. Provincial government departments collect fees when they provide certain services or issue licences and permits to the public. Eighteen departments reported fee revenue in 1964-65, with five departments — Attorney General, Provincial Secretary, Lands and Forests, Labour, and Education—accounting for the lion's share. With $9.9 million in fee revenue, the Department of the Attorney General is by far the leader. The bulk of this amount is composed of fees for the services of Local and Surrogate Registrars, County and District Court Clerks, and other legal officers.[1] Principal sources of fee revenue in the four other leading departments include Letters and Supplementary Letters Patent (Provincial Secretary), campsite and vehicle permits (Lands and Forests), inspection and apprenticeship fees (Labour), and tuition fees (Education). Revenues of the thirteen remaining departments range from the laboratory fees of the Department of Health to the Ontario Municipal Board fees credited to the Department of Municipal Affairs.

5. While it is possible to distinguish conceptually among licences, permits, and fees for service, our own efforts to apply such distinctions in practice have been fruitless. As a practical matter, licences and permits are virtually identical and indeed it is frequently impossible to discern these from the fees collected for permission to use governmental services; in return for a fixed charge, the government

[1]An indeterminate but small portion of the fees collected by the Department of the Attorney General is paid not by individuals but by municipalities as an offshoot of the provincial-municipal division of jurisdiction that currently prevails with respect to the administration of justice. Any fees currently paid to this department by municipalities should be considered outside the discussion that follows. They are covered in the treatment of the administration of justice in our discussion of provincial grants.

bestows some benefit, in the form of a permission to do something that is otherwise forbidden, or in the form of a specific service. Thus can the general term "fees" be applied appropriately to revenues raised from such activities as inspecting boilers or licensing frozen food lockers, registering changes in name, running courses for aspiring hairdressers or selling permits to move houses on the highways. Many of these revenues are similar in nature to the municipal licence, permit and user fees discussed in Chapter 17. To avoid repetition, we refer the reader to the discussion of matters of principle in that chapter which apply with equal force to these provincial revenues.

6. Given the great diversity in the types of fee revenue the province collects, there are bound to be disparities in the way in which the burden of these charges is borne. Marriage licences, for instance, are likely to be paid fully by one of the interested parties, whereas the fees charged for the many licences and permits issued to businessmen may be passed on to others in a variety of ways. In the main, the fees paid by any one individual or organization in a year are quite small, and we are hard put to imagine that there could be any dramatic economic effects resulting from the imposition of these charges.

7. The justification for charging fees is that the government has been put to specific expense to provide services to, or other benefits for, readily identifiable members of the community. Here the government may justly decide to recover the cost of its services or benefits. Thus if an individual wants a search of the records to find the particulars of a birth, marriage or death, he should be required to pay for the cost in time and accommodation that such a search involves. Again, if an individual wishes to do for his own benefit something the government has chosen to regulate as a matter of social policy, he should pay for the supervisory and administrative costs his activity occasions.

8. In our view the main criterion for determining the level of fees charged should be the recovery of all costs that can be related to the transaction. These costs should include the expense of processing the applications, collecting the fees, and providing whatever regulatory or other services may be involved. In addition to the direct costs, a fair proportion of departmental and general overhead should be recovered, including the costs of accommodation, contributions to the superannuation fund, and personnel and accounting services. Fair approximations of the value of these can be determined and should be included in setting fee levels.

9. We recognize that costs associated with a particular service will vary over time, and would not suggest that every small variation in cost be reflected in a change of the fee. We do suggest, however, that a periodic review should be made of all fees charged for services, licences and permits. This function might best be handled by Treasury Board, which is the committee of Cabinet dealing with all matters of revenue and expenditure. To avoid frequent and annoying adjustments, changes should be effected if service costs vary more than, say, 20 per cent above or below the level of fees. In order to ensure that this review will be made, it would

be advisable to incorporate provision for it in the statute. Accordingly, *we recommend that*:

> ***The Financial Administration Act be amended to require that there be tabled in the Legislature a quinquennial review explaining the nature and level of all fees charged by the government.*** **37:1**

10. While the criteria which we suggest are applicable to most fees, we recognize that there may be instances in which the government will not want to follow the cost-recovery pattern if this would hinder the attaining of some overriding goal of social policy. Thus, for example, we have recognized in another chapter the propriety of having the whole population share in the unusual profits made possible by the granting of liquor licences. There may also be instances where it is appropriate to recover less than the full cost—as in the registration, supervision and training of apprentices. We do not suggest that this is in any way improper or unfortunate. It is a function of government to decide objectives and choose the best means for their accomplishment. What we want to ensure is that the government does not deviate from an equitable and proper set of charges without a conscious decision so to do.

11. For many services that are to be subsidized, we suggest that the most advantageous method is to set a proportion of the full cost that fees are expected to cover. In this way the charges will always be directly related to the cost of the service, even though they may not fully meet the cost. Tuition fees are examples of charges that could best be handled in this manner. For other services—the licensing of day nurseries, for instance—a purely nominal charge may be the most appropriate if this is a matter of conscious government policy.

12. One other point deserves mention before leaving this subject. When fees are shared between the Province and municipalities, as are those for marriage licences, it is perhaps obvious that the manner in which the apportionment is made should be determined by the costs incurred by each level of government in providing the service.

SALES AND RENTALS

13. Sixteen government departments reported $14.1 million in revenue from sales and rentals in 1964-65. Some $5 million of this amount—much of it in the Department of Health, which leads in sale and rental revenue—is realized from the provision of meals and accommodation to civil servants, certain patients in Ontario hospitals, and other classes of individuals. Other departments—of which the Department of Reform Institutions with $3.4 million is a leading example—derive revenue from the sale of agricultural, consumer or industrial goods. Departments such as Highways, Lands and Forests, and Public Works report earnings of several millions from the sale of lands, buildings and materials. The sale and rental revenue of other departments runs the gamut from cattle (Agriculture) to Orders-in-Council (Prime Minister).

14. The types of sales in which government departments engage can conveniently be divided into three broad categories. The first is the kind that results from continuing operations of a commercial nature. The souvenir shops operated by the St. Lawrence Parks Commission may be examples of this type. The government should review what portion of its sales revenue can be deemed to derive from facilities that are similar, in nature and purpose, to privately operated businesses. Here prices should be comparable to those charged elsewhere. Such a policy will tend to optimize revenue and prevent any governmental undercutting of private competitors. A second type of sales involves such articles as orders-in-council and other official publications over which the government has a natural monopoly. In these instances, sales prices should cover all costs associated with producing the articles. Hence, for example, the prices of government maps should be such that the activity is not subsidized by the general revenues of the Province unless there is a clear policy directive to the contrary.

15. The third and final class of sales made by the government arises as a subsidiary offshoot of its normal operations. Most of these transactions are non-repetitive, arising, for example, only when there are surplus lands or equipment that the government wishes to dispose of. In these instances, we deem it important to ensure that sales revenue be maximized. A corollary of this principle is that no one should enjoy an unfair advantage by being permitted to purchase government property at bargain prices. The best way of attaining these objectives is to ensure that government goods and properties are sold by a form of public auction or tender, as with the sale of Crown lands for cottage purposes. We note that this policy is adopted for the most part throughout the various departments. There will always be some cases where such a procedure is unsuitable, but these are few. Fully adequate justification should be required before any other procedures are used for sales of this type.

16. Much of the government's rental revenue arises from the simple fact that it requires a large field organization of civil servants working throughout the province. In many areas where civil servants are placed, housing is either scarce or unavailable. Hence the government currently provides accommodation for over 2,000 employees and many of their families. These employees must pay "perquisite" charges for rent as well as for any other services that might be provided such as power and laundry. In setting the price of rented accommodation, the government takes into account rents charged for similar non-government property in the area, and may allow discounts for certain personal factors. The latter include job-imposed restrictions on the freedom of the employee to choose his domicile, lack of privacy or unsuitable size. Charges for ancillary services are set to recover the cost of providing them.

17. In addition to renting housing to employees, the government leases other properties. Major examples include Crown lands leased for cottages, resorts and grazing, highway property such as service areas leased for gasoline stations and restaurants, and Crown-owned buildings leased by the Department of Public Works

to government agencies or private tenants. Revenues from such properties total nearly $2 million annually.

18. Essentially the same considerations apply to rentals as to sales. As a general rule rents should be determined by tender, or be set at a level similar to that which applies in the private sector of the economy. Where the government must rent housing to its employees the terms of occupancy should be similar to those applying to comparable quarters in the area. It is equitable to make a rental adjustment if the employee is required to live in a particular house, or his privacy is intruded upon to a greater extent than it would have been had he lived elsewhere. By and large the government has adopted these principles and we are not recommending any specific departure from present practice with respect to rentals.

FINES AND FORFEITURES

19. At $2.9 million, fines and forfeitures form a very minor component of provincial non-tax revenues. Here two departments, Attorney General and Transport, dominate in a setting where only two other government departments collect any revenue, and this amounts to only $59,000. Attorney General revenues of $1.4 million are derived from general fines and forfeited bail, while those of Transport, also $1.4 million, stem from fines for breaches of The Highway Traffic Act.

20. Fines and forfeitures result from the enforcement of laws and regulations—their function is to serve as penalties for transgressions. We deal elsewhere with the division of fine revenues between the Province and its municipalities in that this division is affected by their respective roles in the enforcement of the law. For the purposes of this chapter, we simply recognize that the levels at which fines are set must be determined entirely by the size of the penalty deemed necessary to deter persons from engaging in prohibited activities. Accordingly, the criterion of cost recovery cannot apply here. We make no recommendation about the amount of particular fines, and suggest only that they be reviewed from time to time with particular attention to their effectiveness as deterrents. In no event should the government come to depend on fines as a revenue instrument for general or specific purposes.

OTHER MISCELLANEOUS REVENUES

21. Eighteen departments reported approximately $1 million in odds and ends for 1964-65. Generally identified in the Public Accounts merely as "miscellaneous", the only item of any consequence is labelled "escheated estates". Assets of estates which, in the absence of executors or administrators, are under the jurisdiction of the public trustee are escheated and paid into the Consolidated Revenue Fund if they are not claimed by an heir within ten years after the death of the decedent.

22. There is little similarity among the several types of other miscellaneous revenues and, since it is impossible to categorize them, we do not choose to make any recommendations concerning them. We are satisfied to reiterate our general

principle for most non-tax revenues: if an identifiable service can be associated with the revenue which is raised, the amount charged should be such as to allow a full recovery of the direct and indirect costs of the service.

TABLE 37:1

OTHER NON-TAX REVENUES OF PROVINCIAL DEPARTMENTS
1965

(thousands of dollars)

Service, Licence and Permit Fees		
Department of the Attorney General	9,915	
Department of the Provincial Secretary	2,273	
Department of Lands and Forests	1,525	
Department of Labour	1,421	
Department of Education	1,149	
Thirteen other departments	4,268	
Total, eighteen departments		$20,551
Sales and Rentals		
Department of Health	4,183	
Department of Reform Institutions	3,403	
Department of Highways	2,240	
Department of Lands and Forests	1,393	
Department of Public Works	1,343	
Eleven other departments	1,574	
Total, sixteen departments		14,136
Fines and Forfeitures		
Department of the Attorney General	1,438	
Department of Transport	1,413	
Two other departments	59	
Total, four departments		2,910
Miscellaneous		
Total, eighteen departments		1,055
Grand Total		$38,652

Source: Ontario, *Public Accounts, 1965.*

Chapter 38

Financing Hospital and Medical Care

INTRODUCTION

1. The provision of hospital and medical care, encompassed in the comprehensive title "health services", now makes the third heaviest demand on provincial government budgets, exceeded only by expenditures on education and highways.

2. Analysis of the government's responsibilities in this area is complicated by the tradition of self-reliance that has long characterized the voluntary provision, on an individual and a collective basis, of hospital and medical care. The comparatively recent assumption by government of responsibilities in this sector is, as the Royal Commission on Health Services reported, attributable to the "deepening of our humanitarian concern for our fellows", and to the "growing awareness of the cost to society as a whole of failure to be concerned and to act on behalf of its members".[1] This transformation in public attitudes and expectations lies beyond the terms of this inquiry. We accept the changed (and still changing) climate of opinion as a fact of life. Nevertheless, we are inescapably drawn into an examination of the various components of the health services program, the

[1]Royal Commission on Health Services, *Report*, Ottawa: Queen's Printer, 1964, Vol. I, p. 5.

complex financing required to support and develop these services, and the impact on governments, on premiums and on taxpayers of the different methods employed for offsetting these expenditures.

3. The task the Committee has set for itself is made difficult by four prominent features of health services. The first of these, the tradition of voluntary support, has already been mentioned. The value of the important voluntary service contributions made by both professional and lay citizens cannot be estimated, but these do appreciably reduce the total costs of hospital and medical services and alter the incidence of the burden they impose. A substantial but incalculable amount of money comes from private donations and from individual payments made outside insured coverage. These expenditures form part of the total costs to the community of providing health services but cannot be incorporated with the figures we employ later in this chapter. Their omission should not be interpreted to mean that we discount the importance of voluntary contributions in support of health and hospital services. On the contrary, we believe that the extension of government financing of health services should not discourage the maintenance of a high level of voluntary support through services, private bequests and donations. The amounts involved not only provide a significant contribution to the satisfaction of our total needs but are tangible evidence of the local communities' meaningful identification with services that would otherwise become too depersonalized.

4. The second feature that makes our task difficult is that, apart from the unidentifiable amounts just mentioned, revenues for health services are secured from the budgets of several governments and from the insurance premiums paid by groups and individuals.

5. Third, not only is there a mix of private and public contributions in many forms but there is also a complicated sharing of costs between federal, provincial and municipal authorities. Thus the health field is an outstanding example of that meshing of financial and administrative machinery which has increasingly characterized efforts to grapple with the provision of costly services within a federal structure.

6. Finally, the all-inclusive umbrella of "health services" shelters a varied assortment of functions and agencies, each with its own peculiar traditions and needs. These have led to separate modes of financing, so that each program may raise quite distinctive policy considerations. For these reasons, it will be useful to begin with a description of the various components of the health program of the Province before we undertake an examination of the financing formulas now in use.

THE MAJOR COMPONENTS OF THE HEALTH SERVICES OF ONTARIO

7. Over many years the provincial Legislature has approved a number of statutes to govern the comprehensive provision of hospital and health services to the residents of Ontario. There are at least fifteen relevant Acts on the provincial

statute books. In one category are those enactments explicitly concerned with the treatment of a particular clientele or a specific disease—e.g., mental care, treatment of children, workmen's compensation, or treatment of cancer. Another group of statutes is primarily regulatory, providing for such matters as the registration and regulation of associations offering hospital or medical services on a non-profit, prepayment basis, and the licensing and inspecting of private hospitals. A third category of statutes is more comprehensive in nature, such as The Hospital Services Commission Act, The Medical Services Insurance Act, and The Public Health Act. There are, in addition, several federal Acts that are designed either to look after the needs of such selected groups as Indians and veterans or, more generally, to provide a variety of grants in support of provincial health programs.

8. The most costly component of the governmental health service program is hospital construction and operation. The term "hospital" is applied to a variety of institutions, each of which may be performing one or more of a number of related tasks. In broad terms these tasks can be described as:

(a) care of the sick and injured, with a further subdivision of functions based on the nature of the care provided: i.e., active treatment, convalescent care or chronic care;

(b) medical training and teaching of physicians, nurses and other personnel;

(c) promotion of public health; and

(d) advancement of research in scientific medicine.

9. Clearly, in terms of contemporary demands on the services provided by hospitals, each has become a potent instrument for the application, dissemination and advancement of science and techology in their relation to human health. In considering appropriate measures for financing modern hospitals, we must bear in mind their complexity, the interrelatedness of their many functions, and their potential as seed-beds of scientific development in a dynamic period of change. Because governments themselves have fragmented their programs of financial assistance to hospital and health services, the ensuing analysis takes up each component separately. For this reason we have stressed in these preliminary comments our firm conviction that hospitals and related institutions must be viewed, by those responsible for meeting their needs, as complex, multi-functional entities.

10. Heading the list of institutions broadly designated as hospitals are 218 public hospitals which in 1965, with 40,467 rated beds, accounted for over half the rated beds provided for health services in the province. Of these, 20 were owned and operated by municipal authorities; the remainder, reflecting the tradition of voluntary support that has characterized the provision of hospital care in the province, were administered by local community boards under the jurisdiction of the Ontario Hospital Services Commission. The next largest group of hospitals, with 15,322 beds, accounting for more than 30 per cent of bed capacity in 1965, were the 15 mental hospitals owned, staffed and operated by the provincial government. Also operating in conjunction with Ontario's hospital

plan were the sanatoria for the treatment of tuberculosis, of which there were 12 in 1965, with 2,510 beds. Federally operated hospitals in the province participating under the federal-provincial plan numbered 11 in 1965[2] and provided an additional 3,666 beds for selected national defence personnel, Indians and many veterans. In addition, privately owned hospitals, totalling 47 in 1965, with 1,370 beds, provided insured hospital services under annual contracts negotiated with the Ontario Hospital Services Commission; to these can be added 40 private nursing homes, which are temporarily approved by the Commission under renewable annual agreements to provide 749 chronic care beds. Centres for Rehabilitation and Crippled Children (an insured service) should be added to round out the structure designed to provide institutional health services for the populace of Ontario.

11. The institutions that provide health services on an active, convalescent/rehabilitation, or chronic basis for the care and treatment of the sick and injured must also aid in producing the professionally trained staff required to provide services within a hospital setting and throughout the community. The training and education of doctors and nurses is a combined operation that primarily involves universities and hospitals. Seventeen of the 218 public hospitals are formally designated as medical-teaching hospitals, though it could be said that the majority of hospitals are involved in a continuous training program for various types of health personnel. Medical research is conducted not only in the medical schools but also in units within hospitals or under the auspices of such agencies as the Alcoholism and Drug Addiction Research Foundation or the Ontario Cancer Treatment and Research Foundation.

12. Finally, there is a veritable maze of agencies concerned broadly with the field of public health, in which prevention, diagnosis, inspection and a strong element of welfare (e.g., care of the indigent patient) are all mingled together. In this varied work, municipal departments of health, community public health centres and health units, homes for the aged, public health laboratories, home nursing services and school dental and medical services all proliferate throughout the community to make their own specific contribution to general public health services. The one essential element in this bewildering array of private and public agencies is the medical profession, its members variously involved in all these operations but still predominantly self-regulated and self-employed and still preserving a highly personal doctor-patient relationship.

13. The mounting costs of providing these personal services, the increasing costs of institutionalized care, and the rising public demand for such care at the highest possible standard have combined to induce governments to share these financial burdens with the individual and his family. In Ontario, government sponsorship and subsidization of more or less universal health insurance schemes have been the preferred methods of achieving this aim.

[2]On October 1, 1966, Sunnybrook Hospital was relinquished by the federal government, reducing to 10 the number of federally operated hospitals in the province, operating under the federal-provincial plan.

14. Government sponsorship and subsidization of health insurance in the province have progressed through two important stages. The first stage was reached in 1956 when the Ontario Hospital Services Commission was created. The Commission not only was vested with the broad mandate "to ensure the continuance throughout Ontario of a balanced and integrated system of hospitals and related health facilities" but was subsequently made responsible for administering the Ontario hospital care insurance plan, which came into operation on January 1, 1959. This step was prompted by the prior enactment in April 1957 of the federal Hospital Insurance and Diagnostic Services Act, which offered all provinces a conditional grant designed to encourage a national program of hospital insurance that would be provincially administered. Initial disagreement over the mandatory premium plan envisaged in the federal Act was resolved in 1958. In the compromise that was reached, Ontario accepted the compulsory insurance feature for all employee groups numbering fifteen or more, permitted employers in smaller firms with groups of as few as six employees to join voluntarily, and also admitted individuals on a voluntary basis. In effect, the government-administered hospital insurance plan provides a basic standard ward coverage that includes, it is now estimated, over 99 per cent of the population of Ontario. Individuals or groups are still free to insure with private companies for additional medical services and for preferred hospital accommodation above the ward level.

15. The significance of these developments for the Government of Ontario is two-fold. First, through the Ontario Hospital Services Commission, the government now administers a virtually universal hospital insurance scheme. Not only does the Commission collect and disburse moneys for the Plan, but it controls charges to patients in all participating hospitals and also regulates the insurance contracts that provide hospital benefits supplementary to those available under the Act. Second, since premium payments fall far short of total costs, the government faces a heavy financial commitment to subsidize the Plan.

16. In 1965, Ontario took a second important step when it approved The Medical Services Insurance Act and thus paved the way for the Ontario Medical Services Insurance Plan—familiarly known as OMSIP. Enrolment in OMSIP is voluntary and on an individual basis. The Plan does not seek to absorb group medical service plans already in existence—which, incidentally, are more widely adopted in Ontario than in any other province. (Before introduction of OMSIP, coverage by these existing plans was estimated by official source at more than three-quarters of the population.) One of the two basic purposes of the Plan is to provide, through the Medical Services Insurance Division of the Department of Health, a licensed carrier for two classes of persons, who are considered to merit relief from part of all of the premium cost. These are persons with little or no taxable income, who are given partial or full relief, and persons receiving benefits under such Acts as The Blind Persons' Allowance Act, The Disabled Persons' Allowance Act, The Old Age Assistance Act, who are automatically given fully-paid

coverage without charge. The second purpose of OMSIP is to provide a medium, Medical Carriers Incorporated, by which licensed carriers of medical insurance can develop views on rates, charges and facilities, to be relayed to the Medical Services Insurance Council. This Council, in turn, advises the Minister of Health on matters relating to the general form and content of extended contracts for medical services insurance. As with the hospital care insurance plan, OMSIP adds new governmental co-ordinating or regulatory machinery and, for individuals in low income brackets and for those already in receipt of special allowances under other provincial statutes, commits the general public to a substantial scheme of subsidies to be paid out of general revenues.

FINANCING ONTARIO'S HEALTH SERVICES

17. The funds required to support the manifold activities of the various components of health services in Ontario are derived, as we have already indicated, from a number of sources. Viewing the general picture, and disregarding for the moment the detailed allocations, we find there are five financial tributaries feeding into the mainstream of financial support for all health services in the province.

18. First, there are the voluntary contributions made by individuals and businesses as philanthropic or "charitable" donations, particularly in support of general hospitals. In addition, there are payments made by uninsured persons or by insured persons desiring a level of service beyond standard ward care. The sums involved here might well be termed the "invisible" portion of the health bill paid by the people of Ontario. Substantial as these voluntary payments may be, they have not been included in our calculations because our major interest centres on government expenditures and the revenue sources for meeting such expenditures. Nevertheless, as we have already noted, their continued flow into the mainstream of hospital financing should be encouraged to offset the impression that massive governmental support has completely eliminated the need for voluntary support.

19. The second source of financial support consists of the premium payments from individuals who participate in the two major insurance plans and the payroll assessments used to finance the Workmen's Compensation Fund. OMSIP commenced its first year of operation on July 1, 1966, and at the time of writing our Report there were no figures available on the premium payments made by individuals; however, estimates for the 1967-68 fiscal year include sums aggregating $59 million for coverage of insured persons who pay partial or no premiums. In 1965 individuals and groups, and governments on behalf of individuals, paid $153 million in premiums into the hospital insurance plan. Completely separate is the Accident Fund, built up from the assessment of employers' payrolls made by the Workmen's Compensation Board. It is used to compensate workmen injured or incapacitated as a result of accidents at work, and also covers the costs of medical and hospital care, some of which is provided in the Board's own hospital and clinical rehabilitation centres. In 1965, the payroll assessment for workmen's

compensation was over $88 million, nearly three-fifths as large as the premium payments into the hospital insurance scheme.

20. The federal government is the third source of funds for health services. For the fiscal year ended March 31, 1966, its total contribution to the construction and operation of Ontario's hospitals, together with grants for sundry health services programs, amounted to $174 million. In addition, a portion of the federal funds is disbursed through such agencies as the Medical Research Council and the Department of National Health and Welfare. Most of these disbursements are in the form of fellowships and research grants to individuals engaged in medical training and research in Ontario. The federal grants to the Province are made in respect of shared-cost programs and a variety of conditional awards that receive detailed examination below. Finally, the federal government administers and finances in Ontario ten hospitals of its own for the care and treatment of defence personnel, veterans and Indians.

21. The Province of Ontario, the fourth source of funds for health services, contributed from its general revenues in the fiscal year ended March 31, 1966, close to $187 million in grants for hospitals and other health services in the province. The bulk of this money—$166 million—went to hospitals in capital and operating assistance toward insured services, over one-half of which was for mental and tuberculosis hospital care; the remaining $21 million was spent on public health and medical research grants. Of the $166 million that went to hospitals, approximately 81 per cent was for operating costs and the remaining 19 per cent was for construction purposes. The emphasis in Ontario on treatment and public health services has been reinforced by the contributions now being made to OMSIP, which are estimated for the 1967-68 fiscal year, the first full year of operation of the Plan, at $59 million.

22. Local governments, as the fifth source of funds, are relatively junior partners in the collaborative financing of health services in Ontario. In the calendar year 1965 they spent about $17 million[3] on this sector, of which nearly $2 million was for maintenance of indigents in public hospitals and the remainder was used for hospital deficits and a variety of public health programs. In addition, the Ontario Municipal Board in 1965 approved municipal expenditures of $15.7 million for hospital capital purposes. In recent years the proportion of total local expenditures allocated to health services has remained relatively unchanged; however, the municipalities' contribution to the total cost of health and hospital services has declined relative to the contributions from provincial and federal governments.

23. The following tabulation summarizes the position of the four major contributors to public health and hospital services in Ontario, omitting the "invisible" contributions made voluntarily by individuals and business concerns on their own account as well as the payroll levies for workmen's compensation.

[3]Part of this amount is reimbursed through provincial grants.

Table 38:1

MAJOR SOURCES OF FINANCE FOR ONTARIO'S HEALTH PROGRAM, 1965

Source	*Amount* (*millions*)	*Percentage*
Premium payments	$153	27.4
Federal government	186*	33.3
Provincial government	187*	33.4
Municipal governments	33	5.9
	$559	100.0

Source: Ontario, *Public Accounts, 1966*; Ontario Hospital Services Commission records; Ontario Municipal Board *Annual Report, 1965*; *Annual Report of Municipal Statistics, 1965*.

*Figures are for the year ended March 31, 1966, the nearest fiscal year to 1965.

FORMULAS FOR ALLOCATING MONEY TO COMPONENTS OF HEALTH PROGRAM

24. Identification of these major sources of support is but a necessary prelude to a more searching examination of the ways in which moneys are allocated to the various components of the health service structure previously described. At an earlier stage of our inquiry we assumed the continuation of the existing system of shared-cost programs and conditional grants and we were disposed to offer detailed suggestions and recommendations designed to strengthen and improve this system. The Report of the Royal Commission on Health Services, by anticipating many of our proposals, has relieved us of the necessity of entering into such a detailed exposition, other than to state where our own views coincide with or depart from those expressed in that Report. Moreover, in October 1966, during the course of federal-provincial negotiations, the federal government offered to transfer to the provinces responsibility for all health service programs, in return for further abatement of personal income tax. While all the provinces rejected this offer, we endorse this proposal in principle. With a buoyant tax base such as the personal income tax offers, Ontario would in our view be in a position to develop its own broad-based health services program, unfettered by federal conditions or constraints.

25. In the light of these significant recent developments we propose to consider first the shared-cost program of hospital construction grants; second, the corresponding hospital operating grants; and third, the miscellaneous array of conditional grants, each of which is earmarked for a specific program or project.

HOSPITAL CONSTRUCTION

26. The capital costs of constructing, renovating or altering public hospitals that come under the provincial hospital insurance scheme are financed in part by federal and provincial grants under a cost-sharing program. The federal grants are allocated to the provinces on the basis of population and restricted to a total sum for all provinces of $20 million. The formula used is the lesser of $2,000 per

bed or one-third of the construction cost. The same basic formula is used by the Province, but the amount is slightly over one-and-one-half times the federal grant, being the lesser of $3,200 per bed or 50 per cent of the construction cost. The provincial grants cover some facilities that do not qualify for the federal grant. Some grants, such as those for hospitals in northern Ontario, are larger; those for special facilities such as psychiatric and detention beds rise to as much as $8,500 per bed. In September 1966, the provincial government assumed responsibility for two-thirds of the approved cost of new hospital construction. The Province agreed to loan hospitals the difference between two-thirds of the cost and the amounts received by way of provincial and federal grants. The hospitals are to use part of the differential income on private and semi-private rooms toward the cost of retiring such loans. Provincial T.B. sanatoria qualify for the federal grant and also receive construction grants from the province ranging from $1,000 to $2,500 per bed. Finally, the Province on its own account offers annually a special rehabilitation grant of $75 per bed for such varied purposes as debt repayment, purchases of equipment, and additions to endowment. Hospitals deemed by the Ontario Hospital Insurance Commission to be in serious difficulty by reason of debt incurred before the hospital care insurance plan may be granted financial assistance under terms of an unmanageable-debt grant. Such grants amounted to $1 million for the 1966 fiscal year.

27. There is no uniform formula used by municipalities in making grants for hospital construction. Some use a formula that provides the lesser of $6,000 per bed or 45 per cent of cost; others limit their grants to 75 per cent of cost remaining after federal and provincial grants are deducted. Ordinarily a lump-sum grant is paid. Since municipalities play a vital role in relation to the individual and collective health of citizens, we favour the continuation of municipal grants toward construction costs. We do, however, question the desirability of a municipality's guaranteeing a hospital's debt, as this seemingly simple gesture tends to remove the valuable self-restraint that the financing of expanding public needs requires. Generally, total requirements can be met only if the grants from the three levels of government are supplemented by private contributions.

28. The present federal grants for hospital construction are, in our view, objectionable on two counts. First, the rising costs and changing standards for hospital construction make the per-bed grant formula too inflexible. There has been only one change (from $1,000 to $2,000) in the federal formula since 1958, and it is reasonable to assume that mounting costs will persistently outpace such a fixed formula. Much to be preferred would be a grant based on one-third of the lesser of actual construction costs or, say, 110 per cent of the national average cost per bed for each of the various classes of hospital construction that are recognized in existing programs. Second, both the national ceiling of $20 million on federal funds available for hospital construction grants in any one year and the method of allocation based on population fail to take account of interprovincial differences in construction needs. Even though Ontario claims the full share of the $20 million to which its population entitles it, in some years the amount has fallen short of what would have been received on the basis of newly constructed capacity were

there no ceiling on the total. No such limit is imposed on hospital operating grants under the federal Hospital Insurance and Diagnostic Services Act and we see no reason for retaining the ceiling on capital construction grants. Accordingly, as long as federal grants for hospital construction are continued, Ontario should seek amendments to the formula, to provide a grant based on a percentage of approved construction costs without the present dollar limit on total awards.

29. The suggestions for amending the federal hospital construction grants assume continuation of the present system. It should be noted that the Royal Commission on Health Services has recommended the merging of these grants into a broader Health Facilities Development Fund. We support the intent of this proposal, particularly because it would establish a firmer and more generous base for federal assistance to medical research and training. In general, however, we reiterate that we would prefer to see the federal government withdraw its hospital construction grant program for Ontario hospitals in return for compensating tax room or abatement. This added revenue source should be sufficient to finance not only the grants at present federal levels, but the increased amounts that the federal government would be required to pay if the federal grants were continued on a basis that would eliminate the features described above that are objectionable to Ontario. *We therefore recommend that*:

> ***Ontario negotiate the withdrawal of the federal government hospital construction grant program for Ontario hospitals in return for further tax room or abatement sufficient for Ontario to assume the responsibility on an adequate basis.*** **38:1**

30. With respect to provincial grants for hospital construction, the same strictures apply as to the federal grants. The per-bed grant, even though set at a higher level than the federal grant, is too rigid. Not only does the fixed formula fail to contend with changing costs but it is ill adapted to a situation where construction costs vary from one geographic location to another. Indeed this rigidity is already acknowledged in the practice of making supplementary grants for northern Ontario hospital construction. The fixed per-bed formula is equally unsatisfactory in coping with the special expenses incurred in construction of hospitals for teaching and research. A study for the Royal Commission on Health Services[4] estimates that the cost of construction per bed is roughly twice as high for these specialized hospitals ($40,000 against $20,000-$25,000 for public general hospitals). The simplest resolution of the legitimate and sometimes exceptionally large differential in capital construction costs would be the adoption of a straight percentage-of-cost grant, in lieu of the per-bed formula. Adoption of this formula for both provincial and federal grants would go a long way toward alleviating the present difficulties in financing the construction of facilities which, because of their special nature or geographic location, have higher costs. In the event that federal construction grants were replaced by tax abatement to the Province as we recommend, it would be necessary to incorporate an appropriate increase in the percent-

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[4]MacFarlane *et al.*, *Medical Education in Canada*, Royal Commission on Health Services, 1964, p. 122.

age of cost covered by the provincial grant. We also recognize that adoption of this alternative formula for financing capital construction carries with it the need to define in detail, by regulations or by advance clearance of each project, all the components of construction that qualify for the grant. *We therefore recommend that:*

Ontario hospital construction grants be changed from a per-bed basis to a percentage-of-approved-construction-cost basis. **38:2**

31. Provincial grants are more generous than their federal counterparts in covering the costs of constructing certain ancillary facilities. Nevertheless, the Ontario practice of excluding administrative offices and maintenance areas as allowable items for hospital construction grant purposes appears to be unwarranted. *We therefore recommend that*:

Ontario hospital construction grants be broadened to cover the costs of constructing the portions of the hospital to be used for administration and servicing. **38:3**

32. Consideration should also be given to liberalizing the policy with respect to sharing costs of renovating and altering hospital structures. Under present policy, major renovations and alterations are treated as capital expenditures and, if they are closely related to patient care, qualify for a major renovation grant of one-third of the cost from each of the federal and provincial governments, with the remaining one-third of the cost being financed by the hospital. Where such major renovations, alterations or repairs do not qualify for the grants, all of the cost must be met by the hospital. "Minor repairs", on the other hand, are recognized as operating expenses and are fully reimbursed to the hospital through the operating grants program. Experience has shown that a hospital confronted with emergency repairs or significant renovations is often compelled to postpone them unless it has accumulated sufficient funds from endowments or from differential charges for private and semi-private accommodation. Moreover, municipal and private donors are less likely to support a renovation or alteration program than the construction of an addition to the building. Thus, lack of capital funds may postpone the work even though substantial savings in operating costs would result from the improvements. We suggest that the Ontario Hospital Services Commission be given the power in such circumstances to allow the entire cost of the renovation, alteration or other major repair, less the amount of any applicable major renovation grants. These costs should be amortized over a reasonable period by the inclusion of an annual charge in reimbursable operating costs. *We therefore recommend that:*

The Ontario Hospital Services Commission allow hospitals to include in reimbursable operating costs an annual amount sufficient to amortize over a reasonable period the cost of renovations, alterations or other major repairs that are not recovered through major renovation grants and that would result in commensurate operational savings. **38:4**

33. Of the three remaining types of provincial construction grants, we think the grant for unmanageable interest-bearing debt is fully justified because the assistance

provided pertains only to debt incurred before the inception of the Ontario hospital insurance plan. The other two grants, for rehabilitation and tuberculosis sanatoria, have largely become outmoded, owing to developments that have occurred since their inception. The special rehabilitation grant of $75.00 per bed was introduced in 1952, well before the present hospital insurance plan. In the 1966 fiscal year, $2.7 million was allocated under this program. These grants bear little relationship to actual needs of hospitals. The money now spent might better be allocated to the reimbursement of annual charges for amortization of major repairs and alterations as proposed in Recommendation 38:4 above. For tuberculosis sanatoria, the happily significant reduction in the incidence of this disease, coupled with the trend to treat tuberculosis patients in general hospitals, suggests that the time is ripe to complete the conversion process of former tubercular care hospitals to other uses. This step could release for other health care purposes approximately $14 million in current assets, semi-permanent investment funds and permanent (endowment) funds, now provided for tubercular care facilities. *We therefore recommend that:*

Upon implementation of the two preceding recommendations, Ontario discontinue construction grants for special rehabilitation facilities and tuberculosis sanatoria. **38:5**

HOSPITAL OPERATION

34. Turning next to the grants designed to assist hospitals in meeting their operating costs, we find the most important federal grant is provided under the Hospital Insurance and Diagnostic Services Act. Operating costs embrace not only costs of treatment but also the whole spectrum of training, research and public health services. All hospitals providing insured hospital services are eligible. Mental hospitals and tuberculosis sanatoria, though qualifying for construction grants, are excluded, presumably because provincial programs in these areas generally had reached some degree of maturity well before large-scale federal subsidization came into effect in the late 1950's.

35. As mentioned earlier, in October 1966, at a federal-provincial conference, the federal government offered to discontinue its health service programs, including hospital operating grants, and substitute an appropriate tax abatement so that the provinces could meet these costs out of their own revenues. While this offer was not accepted by any of the provinces, it indicated the desire of the federal government to withdraw from its present involvement in giving financial assistance to hospitals. We believe that Ontario should at the first opportunity indicate its willingness to accept such a proposal. While we do not wish to give a detailed review of the federal shared-cost program in this area, it may be helpful if we identify the key deficiencies that we think should be corrected if the present program is continued.

36. The formula for determining federal operating grants is a composite one, based on the operating costs of hospitals within the province and on the average operating costs of hospitals across Canada. In our view the formula suffers

from two defects that were not specifically dealt with in the Report of the Royal Commission on Health Services, as well as a number of others that the Commission carefully examined and that therefore require little added comment.

37. The first defect is that the federal formula seeks to combine two objectives: equalization and an incentive to keep costs of operation within bounds. Neither objective seems to us to be particularly well met. If equalization were achieved, the proportion of hospital operating costs paid by way of federal grant would be inversely related to per-capita personal income. Table 38:2 shows 1965 average personal income by provinces and the proportion of hospital operating costs reimbursed by the federal government for that year. The latter figure has been adjusted to include only in-patient services and to eliminate the differences arising from the use of co-insurance in two provinces and from the lack of universality of coverage in three. Thus the figures are as comparable as possible. From the Table it can easily be seen that the relation between affluence and proportion of costs paid by grant is haphazard. So it cannot be said that the grant formula provides any meaningful degree of equalization.

TABLE 38:2

FEDERAL GRANT AS A PROPORTION OF COST OF PROVINCIAL HOSPITALIZATION PLANS COMPARED WITH PER-CAPITA INCOME, 1965

	*Federal grant as a proportion of cost**		*Per-capita personal income*	
	Percentage	*Ranked in descending order*	*Amount*	*Ranked in ascending order*
Newfoundland	55.1%	2	$1173	1
Prince Edward Island	63.2	1	1370	2
Nova Scotia	54.8	3	1485	4
New Brunswick	52.2	5	1376	3
Quebec	49.1	8	1755	5
Ontario	48.8	9	2295	10
Manitoba	52.1	6	1919	6
Saskatchewan	48.6	10	1966	7
Alberta	50.7	7	1976	8
British Columbia	53.4	4	2281	9

Source: Ontario Hospital Services Commission; and Dominion Bureau of Statistics, *National Accounts: Income and Expenditure, 1966.*

*Cost used is that for shared in-patient services. Proportion is calculated as that which would have been paid if all residents were insured and no co-insurance charges were levied.

38. It is also difficult to see how the present federal formula acts as a particularly adequate brake on hospital operating costs in the province. The two-part formula provides Ontario with an amount calculated on the basis of the number of its insured population multiplied first by one-quarter of its own provincial per-capita shared hospital costs and second by one-quarter of the national per-capita shared hospital costs. Yet, in the event that Ontario's hospital operating costs were to soar upwards, the formula would not provide a particularly significant administrative brake. The first part of the formula would still provide one-quarter of the

costs and, since Ontario's operating costs represent one-third of total operating costs for all provinces, the national average would be raised substantially, thereby increasing the amount paid to Ontario under the second half of the formula. We find no virtue in a complicated formula that fails to provide either genuine equalization or adequate control over excessive hospital operating costs.

39. There is a second defect, so far as Ontario is concerned, in the federal shared-grant formula for hospital operating costs. Because Ontario has a non-compulsory hospital insurance scheme, the insured population, which is used as the base of the grant formula, has to be calculated from the number of persons paying premiums, their estimated dependants, the number for whom premiums are paid by municipalities, and the uninsured patients who are indigents or in mental hospitals. Even a slight error in these calculations can have a significant impact on the size of the grant.[5] For provinces with compulsory schemes the number of insured persons is simply equated to total population figures certified annually by the Dominion Bureau of Statistics. Yet the assumption that 100 per cent of the population is insured within a compulsory plan is far from accurate. We understand, for example, that before British Columbia abandoned premiums in 1954, only 78 per cent of its residents paid compulsory premiums. The resolution of this inequitable situation rests in the simple expedient of using total population figures where coverage has reached a relatively high proportion. (We suggest an arbitrary figure of 95 per cent.) A more complicated alternative would be to calculate the federal grant by dividing operating costs by the number of insured persons rather than by the total population of the province. Had such a factor been used in 1961, according to our studies, Ontario would have received an additional $1.5 million from the federal operating grants. On the whole, we prefer the first and simpler alternative of using total population figures where coverage exceeds the 95 per cent level, which all provinces will doubtless achieve.

40. Other features of the federal grants for hospital operating costs have been thoroughly covered by the Royal Commission on Health Services. We are in accord with the Commission's recommendations to extend the scope of the grants to cover more elements of the hospitals' operating costs and active treatment costs in mental and tubercular hospitals. In particular, we underline the proposal to designate those wards of existing mental and tuberculosis hospitals providing active treatment as a "hospital" or a "facility" and thus eligible to share in the costs of such treatment. In view of the trend to integrate such specialized units in public hospitals and the corresponding move to "desegregate" tuberculosis sanatoria by converting them to general hospital use or by moving tuberculosis patients to general hospitals, we expect that the historic distinctive character of these specialized hospital activities will disappear. In our view, federal hospital operating grants should reflect and encourage this transformation by progressively recognizing as sharable costs the operating costs attendant on mental and tubercular hospitalization.

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[5]For example, if all residents had been considered to be insured in 1961 rather than the actual 97 per cent, Ontario would have received an additional $5 million from the federal government.

41. Similarly, as long as federal operating grants are continued, we endorse the recommendation of the Royal Commission on Health Services that expenditures on out-patient services should qualify as sharable costs, particularly as provincial hospital insurance schemes are moving to accept such services as insurable. We are less inclined to accept the Commission's recommendations that all depreciation charges should also qualify as sharable costs for federal grant purposes: in our opinion depreciation, which will result in a return of capital over the life of the hospital, may be appropriate for self-financed projects, but is not appropriate for projects financed by grants from governments.

42. The foregoing comments on federal operating grants have assumed the retention of the present system with certain changes that we consider desirable. Now that the federal government has indicated its desire to abandon these grants, we consider the interests of the Province would best be served if Ontario were to negotiate the withdrawal of the federal government from its program of operating grants for Ontario hospitals as well as construction grants, in return for adequate tax room or abatement. *We therefore recommend that:*

> ***Ontario negotiate the withdrawal of the federal government hospital operating grant programs for Ontario hospitals in return for tax room or abatement sufficient for Ontario to assume the responsibility on an adequate basis.*** **38:6**

43. Contributions to the operating costs of hospitals providing insured services are made from the Ontario Hospital Insurance Fund. In addition to the federal grant, this Fund is fed by premium revenues, a 50 per cent share of the revenues received by hospitals from patients for preferred accommodation,[6] and a subsidy from general provincial revenues sufficient to make up the balance required. The Province also provides special maintenance grants for tuberculosis sanatoria, the formula being based on standard daily cost less 50 per cent of daily revenue collected by sanatoria from their patients.

44. In connection with provincial operating grants, we have only one comment to make. We note that each sanatorium receives a grant from Ontario based on the average cost of patients in all Ontario sanatoria. The use of a provincial average to calculate this operating grant results in paying more to low-cost and less to high-cost sanatoria than is justified by their needs. The inequity could be removed by the simple expedient of relating the grant directly to the costs of each particular sanatorium.

PUBLIC HEALTH, RESEARCH AND TRAINING

45. Federal government support for a wide range of public health, research and training activities in the province is provided by means of an assortment of earmarked National Health Grants that are ultimately paid over by the Province to

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[6]Preferred accommodation charges refer to charges over and above standard ward care which the patient himself must pay or recover from insurance outside the Plan. Hospitals retain half this revenue and are required to transfer the other half to the Commission.

hospitals, health units, municipal departments of health, universities and other agencies. In the 1966 fiscal year, nearly $12 million was granted by the federal government for allocation by the Province to these varied groups.

46. As federal support is predicated on the assumption of full provincial responsibility for maintaining the unit level of services established as of March 31, 1948, the federal grants apply only to increases beyond that level. They are also highly specialized and conditional, necessitating a cumbersome procedure of negotiation between officials of the provincial Department of Health and their federal counterparts, as well as separate approval of budgets by both levels of government. Once approved, the allotment must be spent within the fiscal year or else it lapses and must be considered anew for the following year.

47. At a time when hospital insurance grants on a continuing basis have been successfully developed, it is difficult to understand the need for the retention of the awkward project-by-project arrangement for public health, research and training grants. Co-ordination and the maintenance of general standards can, as in the hospital insurance program, be better achieved by means of federal advisory services and other existing machinery. We would urge, at the very least, that these grants be consolidated and that they be paid on a continuing basis rather than on a year-by-year project basis. This would permit better advance planning and less rigorous requirements for spending a specific allocation within the fiscal year. This proposal conforms with the recommendations of the Royal Commission on Health Services to incorporate all the present National Health Grants into a proposed Health Facilities Development Fund, under a Health Sciences Research Council, and more generally, into the broader Medicare program. The Commission makes one exception to this consolidation proposal, namely, the General Public Health Grant, which in their view should be separately retained and increased from 80¢ to $1.00 per capita.

48. Assuming retention of the present scheme of federal health grants, we join with the Royal Commission on Health Services in recommending consolidation of these grants on a continuing basis. However, if the federal government were to transfer this program to the provinces—as it apparently would like to do—the Royal Commission's recommendation would no longer be applicable. We strongly support the acceptance of the more sweeping alternative, provided that compensating fiscal arrangements with the federal government can be made. *We therefore recommend that*:

Ontario negotiate the withdrawal of the federal health grants program in Ontario in return for tax room or abatement sufficient for Ontario to assume the responsibility on an adequate basis. **38:7**

49. Although this paragraph precedes our discussion of the health grants of the province, it is appropriate to note at this point that, compared to Ontario's program, a much larger proportion of the federal health grants is devoted to medical research. While we consider that medical research has no geographical

boundaries and that it is therefore desirable to use federal tax revenues for its support, we agree with the views expressed in a recent study of medical research[7] that there are many reasons why Ontario should be more interested in providing financial encouragement to medical research than its grants would indicate. Medical research, which has already resulted in so many social benefits, has in addition reduced the need for hospitalization in certain fields and hence has led to a reduction in provincial costs.

50. Ontario's grants for public health, medical training and research embrace a broad spectrum of activities undertaken by government branches and agencies as well as non-government associations such as the Canadian Red Cross Society, and the Canadian Arthritis and Rheumatism Society. Some of these grants, such as the home nursing grant, can be eliminated if our previous proposals for broadening the range of insurable services are adopted. We comment briefly on only three aspects of the provincial grants.

51. First, it is clear that many of the patients now occupying more expensive chronic care hospital beds actually require only custodial care that can be provided at a lower cost in nursing homes or homes for the aged. There is a considerable cost advantage to the Province in encouraging such patients to move out of active treatment areas to other facilities that would provide a level of care more appropriate to their needs.

52. The present pattern of financing provides no incentive to either hospital authorities or patients to transfer the latter from high-cost to lower-cost health service facilities. If anything, the financial incentive for patients—in particular, elderly patients—is to use the higher-cost facilities. An insured old age pensioner receives, with the full supplement, a monthly pension of $105. If he is hospitalized, apart from paying his monthly insurance premium of $3.25, he usually retains the pension to be saved or spent as he wishes. If he is discharged from the hospital and placed in a home for the aged, however, all of his monthly pension except $10 is taken from him to meet the charges for care. Clearly, the financial incentive for him is to remain in an insured hospital.

53. In order to achieve the most economical use of various types of facilities, consideration should be given to ways of encouraging the use of convalescent and nursing homes and similar institutions that make medical and nursing care available to the residents, perhaps by extending insurance coverage or providing assistance to the needy. In addition, consideration should be given to covering the cost of transferring a patient by ambulance from one institution to another, lower-cost one when the patient's medical condition permits. Whatever methods commend themselves for facilitating these transfers, we underline their importance to the achievement of the most effective use of hospitals.

54. Our second set of observations relates to the grant made to assist municipalities in meeting the cost of providing hospital care for indigents. The grant is equal to 80 per cent of the previous year's cost of providing indigent care and is treated

[7] *Medical Research in Canada: An Analysis of Immediate and Future Needs*, December, 1965—a study commissioned by Mr. C. L. Gundy and endorsed by members of the medical profession engaged in research.

as an annual statutory allotment under The Municipal Unconditional Grants Act. In meeting the cost of such care, municipalities may either form collectors' groups of any number to insure municipal indigents or pay a statutory daily hospital rate that covers only about two-fifths of actual cost.

55. In Chapter 21, where we consider provincial grants to municipalities, we recommend that the Province insure, without a waiting period, all persons who become indigent. We also suggest later in this chapter that when future changes in premium levels become necessary, consideration should be given to adopting a scheme of subsidized premiums for people of low incomes comparable to that now in existence for the Ontario Medical Services Insurance Plan. These two recommendations would go a long way toward solving the problems involved in providing hospital care for indigents.

56. Finally, we endorse the recent attempts to use provincial grants as a means of fostering co-ordination of local health units and hospitals. The need for such co-ordination is particularly apparent with respect to hospital planning and construction. The historic emphasis on the close identification of public hospitals with the local community and with management by local boards need not be sacrificed in the search for enlarged units for planning purposes and for a broader base for financing or sharing in the services provided by hospitals. The Royal Commission on Health Services has strongly endorsed regional planning for such purposes. At this point we merely call attention to the importance of these efforts, particularly as they provide support for the conclusions reached in Chapter 23 of our Report. In that chapter we have proposed a new framework of regions and have examined in detail the allocation of functions and responsibilities for health and many other services that would provide a more efficient use of costly facilities as well as a more viable administrative and financial base for such activities.

WORKMEN'S COMPENSATION

57. A substantial part of the medical and hospital care facilities available in Ontario are provided under the auspices of the Workmen's Compensation Board. The services of the Board are financed without drawing on the Province's general medical and hospital insurance plans, or on subsidy from general tax revenues. Moreover, the benefits available under The Workmen's Compensation Act include not only medical aid but also income indemnities to a worker who sustains personal injury or industrial disease in the course of his employment and, where death results, allowances for his burial expenses and for the maintenance of his dependants.

58. The autonomous character of this operation, coupled with the fact that it was subjected to an intensive examination by a royal commission in 1950, and is again under active consideration by Mr. Justice McGillivray,[8] enables us to confine our comments to two specific features of the plan.

[8]Commission on Workmen's Compensation Act, 1950, *Report*, Honourable Mr. Roach, Commissioner, Toronto: King's Printer, May 31, 1950. Mr. Justice McGillivray was appointed in June 1966, as commissioner to inquire into, report upon, and make recommendations concerning The Workmen's Compensation Act upon subjects other than administrative detail.

59. Since the Ontario Act went into effect in 1915, workmen's compensation legislation has been widely adopted by other provinces. To the end of 1965, nearly seven million incidents or work injuries have been processed, with awards totalling more than $1 billion. Awards are made from the "Accident Fund", which is built up from assessments on payrolls of employers. Most employers (over 100,000) are grouped in Schedule 1 and divided into 106 rate classifications according to the type of business in which they are engaged. A table of rates to be applied to each classification is drawn up yearly in advance. While most rates, per $100 of payroll per year, run from $1.00 to $3.00, the whole range runs from 15¢ to $16.00. Included in Schedule 2 are those employers who have not applied or have not been approved for transfer to Schedule 1; examples of employers in this category are provincial and municipal governments, and telephone, telegraph and transportation systems. These employers are individually liable to pay the claims for compensation and medical aid in respect of their own employees in accordance with the scale of benefits provided under The Workmen's Compensation Act without the advantages of pooling enjoyed by employers who come under Schedule 1 of the Act. In 1965, the amount collected from assessments was over $88 million and the amount accumulated in the Accident Fund came to nearly $282 million.

60. It is the fundamental principle of workmen's compensation that the costs of providing this insurance be borne , on a pooling basis, by industry. Since provincial assessments are made in advance, employers are able to take them into account as an item of cost when determining the selling price of their goods and services. In effect, then, as Mr. Justice Roach observed in his Report, the burden is largely transferred to the consuming public, and to this we take no exception.

61. We are concerned with one aspect of the assessment procedures of the Workmen's Compensation Board. We agree with Mr. Justice Roach that it would be "folly to change" the present procedure by which the determination of individual awards is left to the discretion of the Board, subject to no outside review, particularly as this procedure has been endorsed by both labour and management. However, we are inclined to think that decisions of the Board should be subject to independent review when disputes arise over rate classifications assigned to an employer or the establishment of a rate formula. This would be consistent with our views, which we express in Chapter 25, on the necessity of providing independent appeal tribunals in respect of any tax or revenue assessment. We hope that the Royal Commission on Workmen's Compensation will consider this matter.

62. The second observation we should like to make on the operations of the Workmen's Compensation Board concerns the present restrictions on the Board's investment policies. Investments of about $238 million are held in the Accident Fund and other funds of the Board. Such investments, since the depression of the thirties, have been restricted to securities issued or guaranteed by the Province of Ontario or the Government of Canada. In our opinion this curtailment of investment opportunities unduly restricts the capacity of the Board to vary its portfolio.

We suggest that the Board be encouraged to secure higher returns by authorizing it to broaden its investments to include other high-grade securities.

CONSIDERATIONS AFFECTING THE CHOICE OF APPROPRIATE REVENUE SOURCES FOR HOSPITAL AND MEDICAL CARE

63. We have described the major components of the hospital and health services in Ontario and have assessed the methods currently used for allocating to these services funds obtained from the three levels of government, from premium payments and, for workmen's compensation, from payroll assessments. The latter plan, as we have observed, is self-contained, the costs of the assessments on employers' payrolls being largely transferred to the consuming public. Accordingly, we exclude the Workmen's Compensation Plan from the following appraisal of the appropriateness of the proportional contributions to the costs of hospital and medical care made by individuals and governments.

64. Involved in this analysis are the two major plans now in force for the residents of the province: the Ontario Hospital Care Insurance Plan and the Ontario Medical Services Insurance Plan. At present, these two plans exist side by side, with different formulas for financing the services that each provides. However, underlying both plans is a common social philosophy, namely, that no one, regardless of his financial means, shall be deprived of access to the health care and medical facilities that are appropriate to his needs. Both plans also have in common the realization that, on purely practical grounds, a productive community must also be a healthy community, and that it is in society's own interest to reduce to a minimum "human depreciation" through injury and illness.

65. Both the hospital and medical plans assume that the means of achieving these social and practical objectives lies in the adoption of comprehensive insurance schemes. Underlying any scheme of insurance is the acceptance of the value of pooling financial resources to meet the common and high-cost risks of illness, and the implicit willingness of individuals to accept responsibility, as an obligation to society, for the maintenance of their neighbours' health as well as their own. But adoption of the principle of insurance as the means of implementing the foregoing objectives still leaves unsettled the important questions: Who pays for the plan? Should all participants contribute equally?

66. Under private medical insurance schemes the answers to both questions are clear and uncomplicated: only the participants pay and, unless they wish to receive additional benefits, their contributions are usually equal. The application of an unadulterated principle of benefits received as the basis for establishing insurance premiums proved particularly unsatisfactory in meeting the health needs of the community. In the first place, it excluded many persons who were unable to participate in insurance plans because they could not afford to pay the premiums. Second, even for many who could afford to participate, the accelerating costs of hospital and medical care forced constant upward revisions in premiums, which

threatened to overreach the budgets of middle-income groups. When to this factor of spiralling costs is added the increasing social awareness of the humanitarian and practical importance of meeting at least the minimal health service requirements of *all* members of the community, the need for the eventual involvement of government becomes apparent.

67. Once government elects to become a partner in, if not a promoter of, insurance plans that are intended to cover the entire population, it becomes much more difficult to answer the basic questions posed above. Who pays and in what proportion? It is clear that the answers to these questions rest in certain basic social policy decisions that we have previously mentioned but whose wisdom we are not called upon to judge. However, as a Committee concerned with taxation, we are required to consider the implications of the practical means chosen by government to meet the high costs of hospital and medical services through comprehensive insurance plans designed and administered by the Province of Ontario.

68. We direct attention, first, to the Ontario hospital care insurance plan. Table 38:3 shows contributions made in 1965 by premiums paid for insured persons and by the federal, provincial and municipal governments to hospitals offering insured services under the Plan. It will be observed that the revenue from premiums for that year was approximately one-third of the total contributions for operating expenditures and that the federal and provincial governments contributed almost all of the remainder.

TABLE 38:3

PREMIUM AND GOVERNMENT SOURCES OF CAPITAL AND OPERATING FUNDS FOR HOSPITALS IN ONTARIO OFFERING INSURED SERVICES,* 1965

	Capital		Operating		Totals	
	Amount (millions)	Percentage	Amount (millions)	Percentage	Amount (millions)	Percentage
Premium payments	—	—	$153	33.5	$153	29.9
Federal government†	$7	13.0	167	36.6	174	34.1
Provincial government†	31	57.4	135	29.5	166	32.5
Municipal governments	16	29.6	2	.4	18	3.5
	$54	100.0	$457	100.0	$511	100.0

Source: Ontario, *Public Accounts 1966*, Ontario Hospital Service Commission records; Ontario Municipal Board, *Annual Report, 1965*.

*Includes mental hospitals and tuberculosis sanatoria which offer insured services but are not eligible for federal operating grants.

†Figures are for the year ended March 31, 1966, the nearest fiscal year to 1965.

69. Since government grants are paid out of general funds derived from taxation it is, of course, impossible to identify the specific revenue sources used for the purpose of supporting hospitals. In short, this significant portion of financial support is as broadly based as the group of taxes used for general governmental purposes. The individual taxpayer makes his contribution to general governmental revenues by meeting the varied levies imposed by all levels of government. Thus,

he is in no position to determine his precise contribution to the costs of providing hospital services and he is, for the same reason, unable to relate the benefits he receives to the payments he makes indirectly to meet the costs of providing hospital services. To ascertain the burden on the individual taxpayer imposed by the hospital services plan, it would be necessary to explore the incidence of all taxes that go to make up the "mix" of revenue sources for general purposes of the three levels of government. From the analysis of the incidence of taxation made in Chapter 5 weighted for the proportions of the cost met by each level of government and by premiums, we conclude that the levies of significance in the financing of hospital services in 1961 were together mildly progressive for income classes above $2,000 and regressive for the under $2,000 income class. Using the same pattern of incidence for 1965, 66 per cent of the operating costs for hospital services less charitable contributions and revenue from direct patient charges was met from general public revenues raised from levies that collectively were progressive for all but the lowest income class, and that therefore had some regard for the principle of ability to pay.

70. During 1965 premium rates were raised substantially, with the result that the premium component of the revenues used to support hospital services for the year was roughly 34 per cent of the total revenues used to meet operating costs included in the hospital plan. We believe there is justification for maintaining premiums as an important element in the financing of hospital services. The merit of premium payments is that, being direct and known charges to individuals, they provide a means of relating payments to the benefits received. However, a full application of the "benefits received" principle would mean financing the entire cost of the hospital plan through premiums. Under these circumstances, premiums might rise from the present level of $3.25 per month for single persons and $6.50 per month for families to approximately $10.00 and $20.00 per month respectively. Obviously, a large proportion of Ontario residents would find it too expensive to participate in such a plan and, more important, those most in need of the scheme would be deprived of its benefits.

71. We conclude, therefore, that the hospital care insurance plan has been designed not only to provide a service for those who can afford it but also to meet a broader social objective, the maintenance of a healthy population regardless of the financial means of each participant. This being so, we see no alternative to the present pattern of financing partly through general public revenues and partly through premiums. Determining the appropriate proportions to be borne by the public purse and by the private purse becomes a matter of judgment. In our view the existing pattern of financing appears to be a reasonable blend that recognizes not only the principles of ability to pay and benefits received but also the broader social objectives to which the Province of Ontario is committed. *We therefore recommend that:*

> ***Premium rates for the Hospital Care Insurance Plan be maintained at a level to yield roughly one-third of the total financial resources required to meet operating costs.*** **38:8**

72. The foregoing recommendation to preserve roughly the same proportional contribution from premium payments and general public funds is not inconsistent with two changes in the premium structure we now wish to recommend. Both proposals derive from our examination of the other major insurance plan, the Ontario Medical Services Insurance Plan. This plan has a three-step premium rate structure (single person, family of two, and family of three or more). The hospital plan charges only two rates (single person, and families), except for the R.C.M.P. and Armed Forces personnel who, while not personally insurable under the plan, are charged one rate for covering one dependant and another for covering two or more dependants. Had even an extra \$1.00 per month been charged each family of three or more in 1964, an additional sum of \$12 million would have been obtained. Admitting the administrative convenience of a two-stepped structure, improved data processing should make possible a move to a three-stepped structure, comparable to that of the medical plan. Such a change would begin the process of harmonizing the two plans and would come closer to meeting the objective of relating premium payments more closely to the benefits received from the plan. *We therefore recommend that:*

> ***Consideration be given to replacing the present two-tier premium structure of the Ontario Hospital Care Insurance Plan with a three-tier structure comparable to that of the Ontario Medical Services Insurance Plan.*** **38:9**

73. The provisions for premium payments under OMSIP differ from the Hospital Care Insurance Plan in another way, in that they adopt a principle of subsidization. Full subsidization of insurance premiums for medical care is paid out of public funds for those persons currently in receipt of benefits under such provincial enactments as The Blind Persons' Allowance Act and The Disabled Persons' Allowance Act. In addition, insurance is provided under OMSIP without cost to persons who had insufficient income in the preceding year to be liable for income tax. Only one-half the monthly premium of \$5 is charged for medical insurance coverage for single persons with taxable incomes of \$500 or less; only one-half of the monthly premium of \$10 is charged families of two persons that have total taxable incomes of \$1,000 or less; and only 40 per cent of the monthly premium of \$12.50 is charged families of three or more whose taxable incomes amount to \$1,300 or less.

74. Our analysis of the burden of various levies on individuals and families in different income categories suggests that a direct charge, such as the hospital insurance premium, is regressive—that is to say, constitutes a proportionately heavier burden for those in the lowest income groups. We are disposed to believe that the introduction of a scheme similar to that used by OMSIP for subsidizing the premiums of low-income categories in the hospital insurance scheme is warranted. It would be a practicable method of giving full recognition to the broader social objectives of the Plan. At the same time, it would temper the stress on the benefits-received principle which would be accentuated by our previous recom-

mendation to move to a three-tier premium rate structure. *We therefore recommend that:*

When future changes in premium levels become necessary, consideration be given to incorporating into the Hospital Care Insurance Plan a scheme of subsidized premiums comparable to that in the Ontario Medical Services Insurance Plan. **38:10**

75. Any insurance plan in which benefits have no prescribed limit is open to abuse from those who seek to maximize their benefits. Hospitalization and medical care insurance involving judgment or personal rationalization concerning health is particuarly vulnerable in this regard. On this point we received, during the course of our inquiry, conflicting evidence and advice concerning the merits of adding to either or both the hospital and medical care plans a co-insurance or other form of direct patient charge. The latter included such concepts as a deterrent charge per day or per visit, a deductible amount per hospital stay or per year, an experience rebate to those using the service less frequently or an added utilization fee for those hospitals wishing to offer higher levels of hospital service. Of all, co-insurance was most widely advocated. It was also noted, however, that in the final revision of the bill setting up OMSIP, a co-insurance provision, originally incorporated, was dropped. We understand that there were several reasons for this action, the most important being that a health insurance system could not practically insist upon a co-insurance payment when some of the persons covered were being fully or partially relieved from paying the premiums personally. Unless all participants were governed by the co-insurance provisions, many of the benefits of that arrangement would be lost. In any event, we would not wish to propose any monetary condition, however nominal, which would influence a patient's decision to utilize the services which his health demanded. Should experience with the utilization of facilities or with abuses indicate that some additional procedures are required to support the decisions of hospital and medical authorities, further study should be made of all suggestions examined. Of the various types of direct patient charges that we have examined, a co-insurance provision seems to hold the greatest promise. Meanwhile, on discharge patients should be given a receipted hospital invoice showing the cost of the services rendered. This would enhance the patient's appreciation of the benefits received by indicating the actual cost of the services provided, and the extent to which health expenses are being subsidized.

76. In making our two specific recommendations for modifying the structure and financing of premium payments for the hospital plan, we have turned to specific features of the medical care plan for our models. Our proposals in this connection raise the final issue with which we conclude this chapter. Should the hospital and medical plans be integrated?

77. The decision to integrate OMSIP and the hospital care insurance plan is a matter of government policy.[9] In our view, we see no great merit in a long-run

[9]The Minister of Health, the Hon. M. B. Dymond, introduced three bills in the Ontario Legislature on April 28, 1967, which included provisions intended to facilitate the eventual integration of the medical insurance and hospital insurance plans.

approach that does not contemplate eventual integration. In the immediate future, efforts should be directed to harmonizing, wherever feasible, specific features of the two plans so that the ultimate goal of integration can be more readily attained.

78. At present, there are three main differences between the two plans. Two of these relate to premium payments. If our previous recommendations for adoption of a three-tiered scale of payments and incorporation of fully or partially subsidized premiums for low-income groups are accepted, the hospital plan will be brought into closer alignment with OMSIP.

79. The third major characteristic which differentiates OMSIP from the Hospital Care Insurance Plan is its voluntary and individual nature. This contrasts with the compulsory group enrolments required under the hospital insurance plan. The voluntary nature and consequently limited coverage of the provincial medical care plan is one of the points that have been at issue in meeting the federal government's requirement for compulsory coverage. The hospital insurance plan was satisfactorily adjusted to meet initial federal objections to its voluntary nature, and now over 99 per cent of Ontario people are covered by this plan. Because of the subsidization of premiums for low-income categories, we anticipate that OMSIP will grow to the point where it and the government-regulated private medical plans will together achieve virtually the same universal coverage. These private plans already cover about three-quarters of Ontario's population. The only remaining feature distinguishing OMSIP from the hospital insurance plan is that it does not cover employer groups. This difference might be reconciled in the long run by working out an equitable arrangement with the private carriers, who are already closely regulated by the Province.

80. Steps taken in accordance with our recommendations would harmonize the two plans, and longer-term negotiations should bring about their merger. The inclusion of both plans in one premium would in our view be a great step forward in increasing public awareness of the cost of the two major components of Ontario's health program, particularly if the relation of the premium to the entire cost is made clear.

81. The demand for services in a democracy is in part related to the electorate's understanding of the cost to them of providing such services. Where, as for the total health services package, the costs are met from so many revenue sources, it is important to simplify by consolidating the one source—premium payments—that the public can relate to the benefits it receives. It is equally important, lest the general public assume it is getting a bargain, to show that the major portion of the costs of health and hospital programs is provided out of general tax revenues. In this chapter we have sought to emphasize this feature and to recognize in general terms how the burden is distributed. Only with a clearer knowledge of the direct burden imposed by premium payments and of the less visible burden imposed by contributions through general taxes can the public exert an informed and responsible influence on government in the determination of the minimal level of hospital and medical care that should be provided for a healthy, productive community.

Chapter 39

Two Alternative Sources of Provincial Revenue: A Transportation Tax and Lotteries

INTRODUCTION

1. The reader who has perused the preceding chapters of this volume will appreciate that we have already devoted considerable attention to various alternative means of raising revenue which are not found in Ontario. Thus in the chapter on the retail sales tax, we discussed value added, turnover, and gross receipts taxes. Gift and accessions taxes are both treated in the chapter on death and gift taxes. Still other alternative sources of revenue are contemplated in connection with the base of existing taxes—the hotel room tax, for example, which we recommend be imposed under the ambit of an expanded Ontario retail sales tax.

2. There remain two alternative sources of provincial revenue which we have reserved for special treatment in this chapter. The first, a tax on transportation services, is covered here because it is not readily subject to analysis under the heading of general sales taxes. The second, lotteries, is a source of revenue that is as controversial as it is peculiar. Our modest contribution on the subject of lotteries will not enter into the moral and sociological issues which it so often generates but will be restricted to economic and financial implications.

A TRANSPORTATION TAX

3. A transportation tax is a specific excise on the purchase of transportation from a carrier. The tax is usually similar in form to the Ontario retail sales tax in that it is levied on the purchaser as a percentage of the price of a passenger ticket or freight charge. In its usual form, the tax is levied at a fixed percentage of the fare or freight bill, though the actual rate may vary for different types of travel or transport. Thus tax distinctions may be drawn between passengers and freight, and among air, land, and water forms of transportation.

4. In Canada, the transportation tax has a checkered history. It has been levied on occasion only by the federal government and only on passenger travel. The tax made its debut in the war-time budget of 1915 when it was imposed on domestic railway and steamship tickets, foreign steamship tickets, and railway berths and parlour car seats. Increased slightly in 1918, the tax remained in force until 1929. It reappeared three years later in 1932, but was confined to railway berths and parlour car seats. The rate was 10 per cent on berths and a flat 10¢ for seats.

5. Under the stresses wrought by World War II on transportation facilities generally, a comprehensive tax on passenger travel appeared in 1941. Reaching a rate of 15 per cent on all travel tickets, it produced revenue in the order of some $20 million per year. Introduced largely as a means of fiscally rationing war-time travel, the passenger ticket tax none the less survived into the post-war era. When it was finally abolished in 1949, the then Minister of Finance, the Honourable D. C. Abbott, pointed out that in a peace-time setting, "This tax has been a considerable burden in a country like Canada where distances are so great, and it bears somewhat more heavily on people living at greater distances from the main centres of business and industry."[1] No transportation tax has since been levied in Canada.

6. At present, the transportation tax is by no means common, but it is used in some countries. Among the western nations, it has a minor place in the revenue structures of Western Germany and the United States. In the Federal Republic of Germany, the transportation tax is levied on those purchasing transportation services from any business engaged in providing transport at a profit. The carrier acts as an agent of the Republic in collecting the tax from the traveller or shipper. The rate of tax varies between 7 per cent and 14 per cent.[2]

7. Of greater interest in Canada is the transportation tax of its immediate neighbour. During the Second World War, the United States introduced a transportation tax which by April 1944 had reached the rate of 15 per cent on passenger travel and 3 per cent on freight. Statements made at the time of the introduction of the tax said that the purpose of the levy was to raise revenue and to discourage passenger traffic. While events proved that the tax was more than a temporary war-time measure, its survival into the post-war years has been plagued with

[1] *House of Commons Debates*, March 22, 1949, p. 1803.

[2] *Taxation in the Federal Republic of Germany*, Harvard Law School, Chicago: Commerce Clearing House, 1963, p. 213.

controversy. It has been accused in various quarters of hindering economic growth, fostering inequity, and contributing to the decline of the railroad industry. The tax on freight was removed in 1958. By 1962 the rate on passenger travel had been reduced to 5 per cent, and confined to air travel. The small tax on air passengers is now justified as a means of partially reimbursing the federal government for the expenditures which it makes on behalf of the airline industry; many observers, however, view it simply as an expedient.

POTENTIAL YIELD

8. Statistics that purport to show the total amount of money spent on transportation in Ontario are not readily available. But data are kept for some modes of transport, and rough estimates may be made of others. Using figures supplied by the Dominion Bureau of Statistics for the year 1963, we have estimated that approximately $1 billion was spent that year in Ontario for services that might be subject to a transportation tax. Of this amount, some $821 million was for freight and $175 million for passenger transport. A more detailed breakdown appears in Table 39: 1.

TABLE 39:1

ESTIMATED SPENDING ON TRANSPORTATION IN ONTARIO, 1963

	(millions of dollars)		
	Freight	*Passenger*	*Total*
Rail	$358.6	$ 20.7	$379.3
Trucks, Buses, etc.	286.5	58.0	344.5
Water	75.0	5.5	80.5
Air	5.8	90.3	96.1
Pipeline	65.0	—	65.0
Express and Baggage	30.0	—	30.0
Totals	$820.9	$174.5	$995.4

Source: Data supplied by Dominion Bureau of Statistics.

9. These estimates indicate that considerable revenue can be derived from a transportation tax. Given the approximate expenditure for freight and passenger charges of $1 billion in 1963, it is apparent that each percentage point of tax on both kinds of charges might raise $10 million. Levied at the same rate as the present 5 per cent retail sales tax, the yield from the transportation tax would be in the neighbourhood of $50 million annually. Were a transportation tax limited to the passenger travel expenditures of $174.5 million only, but levied at a rate of 10 per cent, some $17.5 million might be realized. Estimating the potential yield of a 10 per cent tax on passenger fares on a somewhat different basis, Professor Eric J. Hanson has indicated that an amount equal to approximately 0.08 per cent of gross national expenditure in Canada might be anticipated.[3] Application of this percentage to the equivalent figure for Ontario indicates a yield of about $14.8 million, somewhat lower but not appreciably different from the $17.5 million that our own estimates indicate.

[3]Eric J. Hanson, *The Public Finance Aspects of Health Services in Canada*, Royal Commission on Health Services, Ottawa: Queen's Printer, 1964, p. 104.

10. Admittedly, any calculation of the potential yield of a transportation tax is hedged about with uncertainty. For instance, the imposition of a transportation tax might be expected to result in an unascertainable substitution of private for public transportation, with a consequent decline in yield. Furthermore, the estimates we have discussed are based on expenditure for transportation not only between different points within Ontario but also from Ontario to points beyond. A transportation tax levied only on charges for transport within provincial borders would accordingly yield appreciably less than we have indicated. Nevertheless, the potential yield of a transportation tax remains considerable, and can safely be said to involve a magnitude of some millions of dollars.

SHIFTING AND INCIDENCE

11. An analysis, however cursory, of the shifting and incidence of transportation taxes must distinguish between a tax levied on passenger travel and a tax on the movement of goods, that is, on freight and express charges. In turn, a tax on passenger travel must be analysed in terms of travel for pleasure and travel on business.

12. If travelling is done for pleasure, it is evident that the transportation tax must be borne by the individual traveller. He is not in a position to shift the burden of the tax elsewhere. Since Dominion Bureau of Statistics data indicate that the proportion of consumer expenditure devoted to transportation is relatively constant among urban families whose income is below $8,000, the tax would be regressive in nature.[4] Admittedly, an individual could avoid the tax by not travelling or, more likely, by resorting more to a private automobile. However, a person who does not own an automobile but who must nevertheless travel will have less opportunity to avoid the tax.

13. A large proportion of travel is done not for pleasure but for business purposes. This is particularly true of air travel, which accounts for half of all expenditures on passenger fares in Ontario. Taxes on business travel will almost inevitably be shifted, at least in the long run. Private firms legitimately consider travelling expenses as costs of doing business and expect to recover all such costs from their sales. Over time, then, that portion of a passenger tax which is levied on business travel will be added to business costs and, where competition permits, will be shifted to the population in rough proportion to consumer expenditure. As ultimately shifted, a transportation tax would accordingly tend to be regressive.

14. When a transportation tax is levied on freight and express charges, as opposed to passenger travel, it is assuredly subject to shifting. This is because only a very small portion of shipping expenditure is paid directly by individuals and is thus difficult to shift. The bulk of the tax would be paid in the first instance by the business firms that absorb shipping charges on their goods, and would be subsequently recovered in the long run from consumers, again in a manner bearing more heavily on low-income, high-consumption groups.

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[4]Dominion Bureau of Statistics, *Urban Family Expenditure*, 1959, Ottawa: Queen's Printer, 1963, p. 26.

ECONOMIC CONSIDERATIONS

15. Ontario's geography, like Canada's, necessitates unusually large outlays on transportation. Long distances between producers of raw material, manufacturers and markets have increased our costs of production and living. In this sense, we are handicapped by our environment both as consumers and as sellers in world markets. There is no doubt that a tax on transportation services would serve to increase this already considerable disadvantage. Prices of Ontario goods in domestic and world markets would be raised and transportation expenditures would become an even larger proportion of personal expenditures.

16. While these effects would apply to the whole province, there would be some areas where the impact would be more severe, as for example in Northern Ontario where shipping and travel expenditures are already heavy. For both freight and passenger travel, the transportation tax discriminates against those who must rely on public carriers. As a result some firms will be given an incentive to provide their own vehicles for shipping goods. A similar incentive would exist for individuals to buy automobiles, or to use the ones they have more than at present. A consequent increase in the costs created by highway congestion would be likely.

CONSTITUTIONAL CONSIDERATIONS

17. No province has tried to impose a tax on transportation services by any method similar to a transportation tax. In the absence of precedent, we obtained a legal opinion on the constitutionality of such a tax, since it seems to raise questions not only of direct and indirect taxation, but also of interprovincial trade.

18. We are advised that a transportation tax might be in good part beyond the taxing powers of a province. A tax on passenger travel purely within the province would be quite in order if the carrier was within provincial legislative jurisdiction, and if the tax was collected directly from the passengers on payment of their fare. This, however, seems to be the only case in which no doubt would be raised. Any levy on freight or express charges is open to interpretation by the courts as an indirect tax. Such an interpretation would be in keeping with our analysis of shifting which indicates that shippers would be able to pass on the burden of the tax to a large extent.

19. A related problem arises in connection with the tax if it is levied on freight or fares for transportation outside the province. This, we are advised, would probably be beyond the powers of the Province, since it would involve taxing interprovincial movements of goods and people. There might also be difficulty if the tax was imposed on the services of a company that was within federal legislative jurisdiction, even though the transport was within the boundaries of the province.

20. We conclude from the opinion which we have received that a provincial government, if it were to impose a transportation tax, would be embarking on a course fraught with constitutional and administrative difficulties. The constitutional difficulties would lead to peculiar administrative contortions in an effort to ensure that the levy was within the legislative competence of the Province. Through the

resulting exemption of certain forms of travel and shipping from taxation, the yield would necessarily decrease and the administrative costs increase. Thus the constitutional implications of the levy present formidable problems and greatly qualify any attractiveness the tax might otherwise have.

CONCLUSIONS

21. A transportation tax, at least in theory, might yield an appreciable return to the Ontario treasury. However, ensuring that the tax did not exceed provincial jurisdiction would pose administrative problems and reduce yield. We recognize, moreover, that Ontario, no less than the whole of Canada, already has to face extraordinarily high costs for transportation because of its great size and relatively small, scattered population. To impose a tax that would intentionally increase the transportation costs already faced would be to impose an unwise burden on the economy of the province and the country. In those cases where the tax could be shifted, it would be passed on in a way that would bear more heavily on the poor than on the rich. Certain side effects of doubtful value might result such as an increase in the use of private vehicles at the expense of common carriers.

22. A large part of the transportation tax would be paid by business in the first instance. In our chapter on the retail sales tax we set out our position on taxes that increase the costs of production, and recommend general exemption for production goods and machinery. To recommend a tax on business expenditures for transportation would be to violate that principle. On the other hand, granting an exemption to business would greatly decrease the yield of the tax and increase the administrative difficulties referred to previously.

23. Our conclusion is that the transportation tax would be a bad tax in Canada and quite unsuitable for the Province of Ontario. We can find no basis on which to recommend that this alternative source of revenue be utilized in Ontario.

LOTTERIES

DESCRIPTION

24. For many years and from many quarters, it has been suggested that the institution of public lotteries would be an excellent way of raising revenue for governmental purposes. It is not our intention to recapitulate all the arguments that have been advanced, but we would like to discuss certain factors that we think must be weighed in the consideration of lotteries.

25. A lottery is essentially an arrangement for distributing prizes by chance among the purchasers of tickets. Three elements—consideration paid for a ticket, prizes to be distributed, and determination of prize distribution by chance—must all be present in a lottery. The most common technique for allocating prizes involves the drawing of numbers from a drum. The drawing is sometimes supplemented by the outcome of an external event such as a horse race.

26. Probably the first public cash lottery since ancient times was established in Florence in 1530, although commodity lotteries were known before that time.[5]

[5]Mabel Walker, "The Lottery—A Perennial Panacea", *Tax Policy*, April-May 1963, p. 2.

From Florence, lotteries spread to France, Spain, Germany, Austria and England, as European rulers recognized their revenue potential. Colonial Virginia adopted a lottery in the seventeenth century, and many other parts of the United States had followed suit by the early 1800's. By this time lotteries were commonly in use to raise money for education, and also for such public works as streets, buildings, water supplies and fire equipment.

27. While gaining ground in the United States, lotteries were losing grace in Europe. Maladministration and overuse stamped them as a disreputable revenue source. As public opposition mounted, lotteries were permanently or temporarily abolished in Britain in 1826, France in 1836, Sweden in 1840, Bavaria in 1861, and Switzerland in 1865. In the last decade of the century, the United States government passed laws closing mails and all inter-state commerce to lotteries. Despite the widespread abandonment of lotteries, several countries continued to use them as a regular and reliable revenue source, while others reinstituted them in the present century. State lotteries are well established in such countries as Spain, Mexico, the Netherlands, Denmark, Austria and Italy. Perhaps the foreign lottery best known in Canada is the Irish Hospital Sweepstake, on which tickets are sold internationally. Extensive use of lotteries is made in Australia where most of the states derive substantial revenues from this source.

28. To the best of our knowledge, no Canadian government has ever made use of lotteries. Our research did turn up one instance in which a lottery was publicly authorized in Ontario, to help finance the construction of the Ontario, Simcoe and Huron Union Railway. At the behest of the directors of the enterprise, the Canadian legislature in 1849 passed a bill permitting the railroad to be financed by either subscription or lottery. Because of the lottery clause, the Governor General reserved the bill for the Queen's assent. One of the railroad's leading backers, Toronto businessman Frederic Chase Capreol, accompanied the bill to London and, to the despair of some and the surprise of all, duly returned in the short space of seven weeks with the royal assent. Capreol thereupon, through unknown means, persuaded the Toronto City Council to invest £100,000 in tickets. The by-law was subject to electoral approval, however, and was soundly defeated at the polls. This ended the lottery scheme.[6] With this single and abortive exception, lotteries are notably absent from the Canadian heritage. They have long been illegal under the Criminal Code, and remain so to this day.

JUSTIFICATION

29. Proponents of lotteries stress the voluntary nature of the contributions made to the public purse through this method of revenue-raising. Here they overlook the fact that while the purchase of the ticket is indeed a voluntary act, the government's "take" of the proceeds is a compulsory levy similar to any tax. But granted that a lottery is indeed a form of gambling enterprise in which the individual can participate or not, as he sees fit, should the government encourage legalized

[6]The railroad, later to become known as the Northern Railway, was eventually financed by more conventional means. Russell D. Smith, "The Northern Railway: Its Origins And Construction, 1834-1855", *Ontario History*, Winter 1956, pp. 26-7.

gambling by running such an enterprise? This is a moral and sociological question that we need not enter into to fulfil our terms of reference. As for the use of a lottery specifically to raise funds for public purposes, we submit that, like any other form of revenue, it should be subjected to the tests laid down by principles of taxation.

30. We are of the opinion that the use of lotteries for raising public revenues cannot be justified according to generally accepted principles of taxation. The principle of benefits received is inapplicable, since there is no way of relating the expenditures on lottery tickets to any specific benefits that may accrue to the purchasers. Similarly the concept of ability to pay fails to justify a lottery since there is no reason to presume that the purchasing of lottery tickets increases at all with income, let alone proportionally. Indeed many economists believe that the poor, lured on by dreams of affluence, are more likely to buy lottery tickets than the rich.

ECONOMIC CONSEQUENCES

31. If government sponsors a lottery, the money spent on tickets will alter the present patterns of saving and consumption by individuals. We do not think it possible to anticipate the aggregative impact of such changes on the economy. It is safe to say, however, that to the extent that lottery tickets become a substitute for other forms of consumption, some decline in the revenues derived from consumption taxes, especially the retail sales tax, would ensue.

32. It may be that at least a part of the money spent on lotteries would be diverted from present expenditures on gambling, either legal or illegal. If it came from what would otherwise be spent at the parimutuel windows of race tracks, there would be a partially offsetting decline in race tracks tax revenue. On the other hand, to the extent that money is diverted from illegal gambling, the effect will be entirely to the benefit of the public sector of the economy. Finally, if ticket purchases are made at the expense of such foreign lotteries as the Irish Sweepstakes, there will be marginally favourable results in the Canadian balance of international payments.

POTENTIAL YIELD

33. There are very few statistics on which to base estimates of the potential yield of a lottery. Furthermore, a large number of variables such as type of lottery, frequency of drawings, and proportion of out-of-province sales and sales to tourists make any estimate necessarily very tentative.

34. We have attempted to estimate the potential yield of a lottery to Ontario by having recourse to the results of the sweepstakes lottery held in New Hampshire in September 1964. On the basis of the prize distribution, it would appear that in the six months before the draw, residents of New Hampshire purchased approximately 243,000 tickets, 0.4 tickets per capita, yielding a gross amount of some $729,000. Out-of-state purchases far exceeded those of residents, however, and involved about 1,667,000 tickets yielding $5,001,000. For each ticket sold within the state, seven were purchased by non-residents.

35. Ontario being more highly urbanized than New Hampshire, its residents might be expected to participate somewhat more actively in a lottery. On the other hand, it is extremely unlikely that ticket sales to non-residents would form nearly as great a proportion of the total as they did in New Hampshire. For one thing, Ontario's tourist industry is proportionately smaller than New Hampshire's; for another, there are indications that New Hampshire's extraordinarily high ratio of out-of-state sales in 1964 was due in part to the novelty of the sweepstake.

36. If we convert the New Hampshire experiment to a twelve-month basis and bear the above stipulations in mind, it is reasonable to expect that Ontario residents might purchase one \$3 ticket per capita, yielding some \$20.1 million. It can be surmised further that sales to non-residents might match those to residents, bringing the total yield to \$40.2 million. If we subtract from this figure—again on the the basis of the New Hampshire experiment—40 per cent for prizes and 13 per cent for administrative costs, the net yield of a lottery to the Ontario treasury would approximate \$20 million.

37. The above estimate, we must make clear, is based on the operation in Ontario of a New Hampshire type of lottery. Lowering the price of tickets, increasing the frequency of the drawings, and changing the size or proportion of prizes all could influence net returns. Similarly, an active promotion campaign and widespread outlets for ticket distribution would doubtless enhance net returns, despite accompanying increases in administrative cost. On the basis of estimates as to the potential yield to the United States government of a pool on such sporting events as baseball, football and basketball with weekly drawings,[7] Professor Eric J. Hanson has concluded that the Canadian government might derive \$100 million annually or 0.25 per cent of gross national expenditure.[8] The equivalent figure for Ontario would indicate a net revenue of some \$45 million, more than twice our estimate of \$20 million, based on a single annual draw. There is thus an obvious if far from proportional correlation between the revenue to be derived from lotteries and the frequency of draws.

38. While the net returns to government from the operation of different types of lotteries are appreciable, three factors that might tend to deflate public proceeds must be borne in mind. In the first place, amendment of the federal Criminal Code to permit lotteries might result in their establishment by a number of provinces. The effect of interprovincial competition would doubtless reduce non-resident sales and lower Ontario's yield. Second, as we suggested above, to the extent that lottery tickets are purchased with money that would otherwise be spent on taxed goods and services, there will be a decrease in the yield of existing taxes. Thus lottery proceeds would be purchased in part at the expense of the retail sales tax, the gasoline tax, the race tracks tax and liquor profits. Third, the costs of administration may consume an increasing proportion of the proceeds. Growing

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[7]Robert K. Kinsey, "The Role of Lotteries in Public Finance", *National Tax Journal*, March 1963.

[8]Hanson, *Public Finance Aspects of Health Services*, p. 105.

revenue demands and interprovincial competition might force more active promotion of lotteries, a process almost certain to be expensive. The cost of ensuring honesty in a lottery is in any event appreciable, and doubtless tends to rise more than proportionately as the frequency of draws and the number of ticket outlets multiply.

CONCLUSION

39. There is no doubt in our minds that a lottery would be fruitful revenue source through which many citizens and visitors to Ontario would cheerfully contribute to the public purse. Little else about a lottery commends itself to us. Quite aside from any moral or sociological considerations, the dominant factor in our view is that this type of revenue source lacks any of the grounds of equity which we think should form the basis of a good tax system. However, if other jurisdictions set up lotteries that draw significant moneys from Ontario citizens, the Province might be tempted to establish a lottery mainly as a defensive measure. Nevertheless, as a taxation committee we cannot recommend that a lottery be used even in these circumstances to raise revenue for the Province of Ontario.

Chapter 40

Provincial Debt Policy to 1975

POLICY ISSUES ARISING FROM REVENUE-EXPENDITURE PROJECTIONS

1. In Chapter 6 of this Report we have developed in some detail our forecasts of annual provincial and local revenues and expenditures until 1975, on the assumption that all present taxation and expenditure programs remain substantially unchanged. The result is a continuously growing gap between expenditures and revenues, a trend particularly striking at the level of the provincial government. These increasing annual deficits would necessitate very large-scale borrowing, the result being that the net direct debt of the Province would have quadrupled, that of the local governments almost doubled and the combined provincial-local debt tripled within the 1966-1975 decade. In view of our forecast that Ontario's provincial domestic product in current dollars will have increased by approximately 60 per cent during the same period, the burden of the combined debt, as commonly measured, would have increased very substantially, to levels that might already have become unacceptable on political and possibly on economic grounds. In particular, the ratio of combined net debt to provincial domestic product would have increased from approximately 18 to 34 per cent—almost a doubling of the

burden. Given our assumptions, it is clear that this trend would continue beyond 1975 and that at some point an intolerable debt position would be reached.

2. In this context, the relevant policy issue is that of deciding in what proportions the government's projected levels of expenditures should be financed by revenues and by borrowing, and in this chapter we advance certain recommendations concerning some basic requirements of a sound provincial debt policy, with particular reference to the forthcoming decade. We shall first discuss the most appropriate behaviour of provincial debt in terms of its secular trend (longer-term average rate of growth) and then conclude with some observations relating to appropriate cyclical (shorter-term) variations from the trend, viewed as a fiscal contribution toward the attainment of economic stability.

3. As presented in Chapter 6, the projected burden of provincial net debt (the ratio of net debt to provincial domestic product) in 1966 is approximately 9 per cent, a figure virtually identical with that of local net debt. During the ensuing decade, the trends of debt at the two levels of government will differ sharply, given the assumptions of the forecast, so that by 1975 the provincial debt burden will have reached 24 per cent, the local burden 10 per cent. In discussing the question of the optimum growth of public debt within Ontario, we think it essential to determine the relevant trend of the combined provincial-local burden. This having been done, it will obviously be the prerogative of the Ontario government to alter the distribution of the combined debt as between the provincial and local levels of government, whether through the re-allocation of tax sources or expenditure responsibilities or through a revision of provincial grants policies. These possibilities we explore at some length in other chapters of our Report.

4. On the basis of historical comparison, the present (1966) aggregate debt burden of governments in Ontario is by no means high. Moreover, while available statistics do not make exact comparisons possible, our study of the best evidence suggests that the ratio of net public debt to provincial product in Ontario is now slightly lower than that for all other provinces taken together. Aggregate public debt in Ontario has fluctuated from an historic peak of some 35 per cent of provincial domestic product during the depressed mid-thirties to a low point of less than 12 per cent during the prosperous early fifties, and as we have just indicated, stands at 18 per cent in 1966. Were the assumptions of our forecast in fact to be borne out, this ratio would have risen by 1975 to the approximate level of the historic peak which coincided with conditions of severe economic depression.

5. It is quite clear that a projected increase of such magnitude—i.e., some 90 per cent within ten years—can scarcely be regarded on any ground as a satisfactory trend in the burden of composite public debt. It is nevertheless appropriate, in view of the prospective continuing growth of the Ontario economy, that the Province undertake a substantial expansion of debt as one means of financing the continuously rising levels of government expenditure forecast during the next decade.

TABLE 40:1

ONTARIO LOCAL GOVERNMENTS ANNUAL REVENUE "GAP", 1966-74
ASSUMED NET CAPITAL DEBT = 9 PER CENT OF PROVINCIAL DOMESTIC PRODUCT
(calendar years)

	1966	*1967*	*1968*	*1969*	*1970*	*1971*	*1972*	*1973*	*1974*
					(millions of dollars)				
1. Provincial domestic product	20,000	21,000	21,600	22,200	23,600	25,000	26,600	28,300	30,000
2. Permissible debt level (9 per cent of P.D.P.)	1,800	1,890	1,944	1,998	2,124	2,250	2,394	2,547	2,700
3. Increase in allowable debt (actual)	—	90	54	54	126	126	144	153	153
4. Increase in allowable debt (smoothed)	—	70	75	85	100	120	140	150	160
5. Interest on allowable outstanding debt*	86	90	94	99	106	113	120	128	137
6. Allowable deficit† (before interest)	—	—20	—19	—14	—6	7	20	22	23
7. Projected deficit‡ (before interest)	—	53	41	47	51	45	37	31	20
8. Additional revenue required, with debt at 9 per cent of P. D. P.	—	73	60	61	57	38	17	9	—3

*Interest is calculated at 5½ per cent per annum on the annual increases in allowable debt.
†Minus sign indicates a surplus.
‡See municipal and school board projections, Chapter 6.

Failure to do so would necessarily be reflected in undesirably heavy increases in taxation, with possible adverse effects upon growth and other economic objectives. An important aspect of any policy designed to effect a specified rate of growth in composite debt is the desired division of this growth as between the provincial and local levels of government.

RECOMMENDATION CONCERNING SECULAR GROWTH OF LOCAL GOVERNMENT DEBT

6. In the light of its historical analysis of the changing financial position of local governments in Ontario, and particularly of the more than two-fold increase in their burden of debt since 1950, the Committee takes the view that the present average 9 per cent ratio of local net debt to provincial domestic product should not be allowed to increase in the period to 1975. Our projection indicates a forthcoming period of relative stability in this particular ratio, which at any time will nevertheless conceal significant and legitimate differences between the debt burdens of particular local governments, given the wide diversity in their particular financial circumstances. We emphasize that this stability which we have projected in the Ontario local debt ratio assumes that no new spending programs will be undertaken and that no major expansion of present programs will occur. Should such increases appear, commensurate increases in the appropriate resources available to local authorities will be required, if the assumptions of our projection are to be borne out. The effect of stabilizing local debt at 9 per cent of provincial domestic product would be to permit the debt to increase at an average rate of some 6 per cent per year; by 1975 it would have risen to approximately $2.9 billion. Lest our readers assume that this maximum recommended recourse to debt financing would relieve the local citizen of any additional tax burdens, we indicate in Table 40:1 the size of the projected annual local revenue gap remaining to be closed, after the allowable increases in debt had been utilized. This Table should be read in conjunction with the forecast of local revenues, expenditures and debt presented in Chapter 6.

PROJECTION OF REVENUE-EXPENDITURE GAPS

7. Line 1 of the Table represents our projection of annual provincial product, from which our assumed permissible local debt level (9 per cent of P.D.P.) is derived in line 2. The annual increases in allowable debt (line 3) are followed by an arbitrarily "smoothed" version of these increases, in line 4. Thus, in 1967, the allowable increase in local debt is shown as $70 million. Given that total interest payments will amount to $90 million (line 5), this debt limitation will be achieved only if the local government accounts record a surplus of $20 million (line 6) before interest payments. In view of the fact that in Chapter 6 we have projected not a surplus but rather a deficit, before interest payments, of $53 million in 1967 (line 7), it becomes apparent that additional revenue of $73 million will be required (line 8) if the increase in local debt is to be confined to the prescribed limit of 9 per cent of provincial domestic product.

TABLE 40:2

GOVERNMENT OF ONTARIO: ANNUAL REVENUE "GAP", 1967-75
ASSUMED NET CAPITAL DEBT = 9 PER CENT OF PROVINCIAL DOMESTIC PRODUCT
(fiscal years)

	1967	*1968*	*1969*	*1970*	*1971*	*1972*	*1973*	*1974*	1975
					(millions of dollars)				
1. Provincial domestic product*	20,000	21,000	21,600	22,200	23,600	25,000	26,600	28,300	30,000
2. Permissible debt level (9 per cent of P.D.P.)	1,800	1,890	1,944	1,998	2,124	2,250	2,394	2,547	2,700
3. Increase in allowable debt (actual)	—	90	54	54	126	126	144	153	153
4. Increase in allowable debt (smoothed)	—	70	75	85	100	120	140	150	160
5. Interest on allowable outstanding debt†	77	81	85	89	94	100	107	114	122
6. Allowable deficit‡ (before interest)	—	−11	−10	−4	6	20	33	36	38
7. Projected deficit§ (before interest)	152	176	264	324	369	454	525	591	723
8. Additional revenue required, with debt at 9 per cent of P.D.P.	—	187	274	328	363	434	492	555	685

*Calendar years closest to the indicated fiscal years.
†Interest is calculated at 5 per cent per annum on the annual increases in allowable debt.
‡Minus sign indicates a surplus.
§See provincial projection, Chapter 6.

8. We have emphasized that we regard the present 9 per cent local debt ratio as the maximum permissible level, and indeed the specific intention of recommendations made elsewhere in our Report is to permit a significant reduction in the burden of local finance. By contrast, we think that a policy that restrains the rate of expansion of provincial net debt to that of the rise in provincial domestic product represents a basically conservative approach to provincial finance. In other words, a policy that simply stabilizes the provincial debt ratio at its present level of 9 per cent represents no more than the minimum reliance that we think should be placed on borrowing, in meeting rising levels of provincial expenditure within the expanding provincial economy. While it is impossible to determine optimum borrowing limits with any degree of precision, the historical experience of the Province of Ontario suggests no economic obstacle to a modest secular rise in the burden of provincial debt, particularly within the framework of a continuously expanding economy. *We therefore recommend that:*

> ***As a partial solution to its projected annual expenditure-revenue gaps, the Province permit a modest expansion of its net debt at a rate at least equal to the growth in provincial domestic product.*** **40:1**

The fiscal effects of net debt expansion at the minimum recommended rate are illustrated below.

9. Table 40:2 is identical in form with Table 40:1 and when read in conjunction with our forecast of provincial revenues, expenditures and debt presented in Chapter 6, illustrates the dimensions of the annual provincial revenue gap until 1975, on the conservative assumption that the growth in Ontario's net capital debt is restricted to 9 per cent of projected provincial domestic product. As in the preceding Table, line 4 represents an arbitrarily "smoothed" version of the forecast annual increases in permissible debt which are indicated in the preceding line. Thus, in 1967, the allowable increase in debt is shown as $70 million. Given that total interest payments will amount to $81 million (line 5), this debt limitation will be achieved only if the provincial accounts record a surplus of $11 million (line 6) before interest payments. In view of the fact that in Chapter 6 we have projected not a surplus but rather a deficit, before interest payments, of $176 million in 1967 (line 7), it becomes apparent that additional revenue of $187 million will be required (line 8) if the increase in provincial debt is to be confined to the present ratio of 9 per cent of provincial domestic product.

10. It will be seen from Table 40: 3 that until 1975 the projected combined revenue gap corresponding to a 9 per cent debt ratio averages not quite $500 million annually, and our studies indicate that the 1975 gap will have reached a level of $800 million. It should perhaps be emphasized that to the extent that the provincial and local governments in Ontario do not generate the indicated additional revenues, the annual revenue gaps will be significantly greater than those indicated

TABLE 40:3*

COMBINED (PROVINCIAL-LOCAL) ANNUAL REVENUE "GAP", 1967-74
ASSUMED NET CAPITAL DEBT = 9 PER CENT OF
PROVINCIAL DOMESTIC PRODUCT

(calendar or closest fiscal years)

Year	*Local Government Revenue Gap*	*Provincial Government Revenue Gap*	*Combined Revenue Gap*
		(millions of dollars)	
1967	73	187	260
1968	60	274	334
1969	61	328	389
1970	57	363	420
1971	38	434	472
1972	17	492	509
1973	9	555	564
1974	—3	685	682

*See Tables 40:1 and 40:2.

in Table 40:3. This will be so because of the consequent higher levels of debt and the cumulative effects of the correspondingly higher levels of interest payments. Assuming that these governments were to close the foregoing combined revenue gaps, the provincial net capital debt would have risen by the end of 1975 to almost $3 billion, an amount corresponding to the maximum permissible level of local debt, with the combined provincial-local levels of debt having been stabilized at 18 per cent of Ontario's projected domestic product during the decade.

CYCLICAL FLUCTUATIONS IN PROVINCIAL DEBT

11. We conclude our discussion of provincial debt by turning from its desirable secular trend to a consideration of its shorter-term counter-cyclical fluctuations which will reflect the adoption of a provincial fiscal policy designed to cope with economic instability. In doing so, we emphasize again that appropriate fiscal policy at any particular time will necessarily reflect current economic conditions. The Ontario government's present practice of financing varying proportions of its capital expenditures from ordinary revenues provides no strong demonstration of support for this proposition. It arises from the desire of the Province to reduce its surplus on ordinary account to purely nominal dimensions, but the size of the initial surplus appears to be determined largely by automatic fiscal adjustments and by policies not primarily determined with reference to their stabilizing effects. *We recommend that:*

> ***In any given period, provincial policies concerning appropriate levels and composition of taxation and expenditures be consciously directed towards the objective of moderating cyclical fluctuations within the Ontario economy.*** 40:2

12. We indicate in this chapter that the present Ontario budgetary distinctions between ordinary and capital items are economically meaningless and even if they were not, the immediate objective of counter-cyclical fiscal policy is to affect the flow of income between the public and private sectors of the economy. This being so, there appears to be no economic basis for regarding a balance in the government's "current" or ordinary transactions as being inherently more desirable than in its "capital" transactions. The former may continue to be necessary, however, as a concession to popular prejudice, until amended budget procedures can strengthen the public's understanding of the potential usefulness of a "national-accounts" budget as a fiscal and economic planning instrument.

13. In the foreseeable future, provincial counter-cyclical fiscal policy will likely need to be effected within the framework of some form of capital budget in which both the level of capital expenditures and the proportion financed by borrowing will vary with cyclical changes in the Ontario economy. To the limited extent that local governments are willing and, with appropriate financial incentives, able to support provincial policy, the effectiveness of such a policy will obviously be increased.

14. As classified in our forecast in Chapter 6, combined provincial and local government capital expenditures will average some 30 per cent of the prospective total expenditures of the two levels of government and will average more than $1 billion annually in the 1966-1975 decade. This figure represents 4 per cent of the estimated average provincial domestic product during that period and appears to provide ample scope for the exercise of some effective counter-cyclical variations in capital expenditures. With regard to variations in provincial revenues, the personal and the corporate income taxes are generally conceded to be the most effective fiscal instruments to be employed for purposes of economic stabilization, the sales tax somewhat less so. We have concluded that the altering of income tax rates by the Province of Ontario, as one means of stabilizing the levels of employment, production and prices within the provincial economy, is both feasible and desirable.

NEED FOR FEDERAL-PROVINCIAL CO-ORDINATION OF COUNTER-CYCLICAL FISCAL POLICIES

15. At various points we have emphasized the view that primary responsibility for the implementation of stabilization policies, whether fiscal or other, must rest with the Canadian government, and it is in this context that we have advanced the view that federal abatement of the personal and corporate income taxes should not proceed beyond the limits dictated by the retention of effective federal initiative in this important area. At the same time, the degree of federal abatement accorded to the provinces in these tax fields should in no way restrict the freedom of action of either level of government to vary its own tax rates in accordance with changing economic circumstances and, in particular, it should not restrict the freedom of the Ontario government to tax at whatever rates it deems appropriate. The economic effectiveness of provincial (and federal) action in adjusting personal and corporate income tax rates will, of course, be markedly influenced by the accompanying response of the other level of government. What is most strikingly borne out by this

situation is that the appropriate dimensions of provincial counter-cyclical fiscal action can be determined only in relation to the scope of federal stabilization measures and that maximum effectiveness will require the closest possible integration of the two programs. The annual meetings of the Ministers of Finance and Provincial Treasurers and, at the technical level, the work of the Federal-Provincial Continuing Committee on Fiscal and Economic Matters for the more recently established Tax Structure Committee, represent encouraging early approaches to a more effective integration of federal-provincial fiscal policy. We attach the greatest importance to the continuing evolution of intergovernmental machinery designed to achieve this end.